

1-1-1981

# Financial Accounting Standards Board (FASB): Activities, July 1973 - February 1981;

Deloitte, Haskins & Sells;

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## Recommended Citation

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# **Financial Accounting Standards Board (FASB)**

## **Activities**

July 1973 — February 1981

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*Reporting Earnings* (Issued July 31, 1979)

*Reporting Funds Flows, Liquidity, and Financial Flexibility* (Issued December 15, 1980)

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*Accounting for Research and Development and Similar Costs* (Issued December 28, 1973)

*Accounting for Business Combinations and Purchased Intangibles* (Issued August 19, 1976)

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*Reporting of Service Efforts and Accomplishments*, P. K. Brace, R. Elkin, D. D. Robinson, and H. I. Steinberg (November 1980)

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## INTRODUCTION

This booklet provides a ready general reference to the activities of the Financial Accounting Standards Board (FASB). It gives a brief description of the FASB, the procedures followed in issuing its pronouncements, and a synopsis of the provisions of the individual Statements, Interpretations, Discussion Memoranda, Exposure Drafts, Technical Bulletins, and Research Reports issued and proposed to date. The booklet concludes with a listing representing those topics under consideration by the Board and its Staff as of January 15, 1981.

The booklet should be useful as a general reference; however, the specific pronouncements should be used if a more thorough understanding is needed.

## BACKGROUND

In March 1971, the Wheat Committee was established by the American Institute of Certified Public Accountants (AICPA) to study methods for formulation of accounting principles. In March 1972, the Wheat Committee proposed establishment of the Financial Accounting Foundation (FAF), the Financial Accounting Standards Board (FASB) and its related Financial Accounting Standards Advisory Council (FASAC). Later that year, Council of the AICPA endorsed the Wheat Committee report and designated the FASB as the body responsible for formulating accounting standards enforceable by Section 203 of the AICPA Rules of Conduct of the Code of Professional Ethics. AICPA Council also named the FASB as the body to maintain prior AR Bulletins, APB Opinions, and AICPA Interpretations.

The FAF was established in June 1972. Ralph Kent, chairman, and eight other trustees were appointed in July 1972. The Foundation's trustees included representatives from five constituent groups including the Financial Executives Institute, The National Association of Accountants, the American Accounting Association, and the Financial Analysts Federation, in addition to the AICPA. Marshall Armstrong was named as the first chairman of the FASB in November; by July 1973 all seven members were in place. The first FASB Statement was issued in December 1973. The APB meanwhile completed its final term on June 30, 1973. In 1979, the Board agreed to assume responsibility for AICPA Industry Audit and Accounting Guides and AICPA Statements of Position (SOP). Also in 1979, the FASB was named by the AICPA as the body designated to issue pronouncements regarding supplementary information under Rule 204 of the AICPA Rules of Conduct of the Code of Professional Ethics.

## MEMBERS

The present FASB consists of the following persons:

- Chairman Donald J. Kirk, formerly a partner of Price Waterhouse & Co. His term expires December 1981.
- Vice Chairman Robert T. Sprouse, formerly a professor of accounting at Stanford University. His term expires December 1985.
- Frank E. Block, formerly a vice-president of Bache Halsey Stuart. His term expires December 1985.
- John W. March, formerly a partner of Arthur Andersen & Co. His term expires December 1984.
- Robert A. Morgan, formerly Controller of Caterpillar Tractor Company. His term expires December 1982.
- L. David Mosso, formerly Assistant Secretary of the Treasury. His term expires December 1982.
- Ralph E. Walters, formerly a partner of Touche Ross & Co. His term expires December 1983.



## PROCEDURES

### Statements

The FASB issues various types of pronouncements. Two, Statements of Financial Accounting Standards and Statements of Financial Accounting Concepts, follow the same procedural process. The FASB consults with FASAC and the Agenda Committee to identify problems, set agenda priorities and appoint task forces to work on problems. On any particular agenda item, a task force defines the problem, does research and prepares a Discussion Memorandum. The Discussion Memorandum is widely distributed and responses are solicited. Once received, these responses become part of the public record. After responses are received, a public hearing is held, usually within 60 days, although at the discretion of the Board, the public hearing may be waived. After the public hearing, an Exposure Draft of a proposed Statement is prepared and issued for public comment. The exposure period is usually 60 days although it may be shorter or longer as necessary. After comments on the Exposure Draft are received and analyzed, modifications, if any, are made and a ballot draft is issued to the Board for written approval. If approved by at least a simple majority (but not less than three) of the members of the Board, the Statement is issued.

### Interpretations

Interpretations are usually initiated by a request for clarification from outside parties. The Board generally consults with the Agenda Committee to determine the extent and criticalness of the specified situation. A proposed Interpretation is then issued for comment; although exposure to FASAC for a minimum of 15 days is required, proposed Interpretations are generally exposed to the public for a minimum of 30 days.

### Technical Bulletins

Technical Bulletins provide guidance concerning the application of official pronouncements. These bulletins are not official pronouncements to which Rule 203 applies. Accordingly, the full due-process procedures of the FASB are not applicable. They are issued by the Staff of the Board, but individual Board members are informed of all matters proposed for Bulletins. These matters may be included in the Board's agenda at the option of the Board. Technical Bulletins usually are not exposed, but may be at the option of the Staff.

### Other

In addition, the Board may issue Invitations to Comment, Research Reports and booklets that help to illustrate Standards. None of these require prior exposure.

## RECENT DEVELOPMENTS

Developments during the last six months include the issuance of two Statements of Concepts, seven Statements of Standards, one Interpretation, two Technical Bulletins, and two Research Reports. In addition, the Board has recently issued a Discussion Memorandum, *Reporting Funds Flows, Liquidity, and Financial Flexibility*, four Exposure Drafts of proposed Statements, and four proposed Interpretations. Also, the Board has issued extended examples of disclosures provided by enterprises that have complied with FASB Statement No. 33, *Financial Reporting and Changing Prices*, during the first year of its application.

However, the overwhelming development during the second half of 1980 was the exposure of the long awaited proposed revision of FASB Statement No. 8, *Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements*

Issued by a narrow 4-3 majority vote, the Exposure Draft, *Foreign Currency Translation*, dated August 28, 1980, soon proved even more controversial than Statement No. 8 itself. The Exposure Draft advocates a current exchange rate for translation of all elements of financial statements, and a local perspective for determination of the basic reporting (or functional) currency as opposed to the dollar perspective of Statement No. 8. Also, Statement No. 8 translates fixed assets, depreciation and inventory at historical exchange rates. Over 300 response letters were received by the Board by the end of the response period. Additionally, four days of public hearings were held. Approximately half of the letters supported retention of Statement No. 8 with modifications for deferral of foreign currency translation gains and losses, the translation of inventories at current rates, and liberalized hedging provisions. The advocates of the new Exposure Draft would prefer it if modifications were made to permit inflation adjustments for financial statements of enterprises operating in hyperinflationary economies, better definition of criteria for choice of a functional currency, and more consistent treatment of investor-investee and investee-investee transactions. At this time, it is unclear what future action the Board may take. It is certain, however, that the Board will give careful consideration to all arguments presented. Many respondents have expressed a wish for a longer response period, one that would enable experimentation with company data under differing reporting standards.

The Board made good progress on its Conceptual Framework project, issuing Concepts Statement No. 3, *Elements of Financial Statements of Business Enterprises*, and Concepts Statement No. 4, *Objectives of Financial Reporting by Nonbusiness Organizations*. Also, considerable progress was made on other Conceptual Framework projects. A Discussion Memorandum, *Reporting Funds Flows, Liquidity, and Financial Flexibility*, marked a significant milestone in that area. Considerable progress was evidenced by the issuance of two Research Reports in the area of accounting recognition criteria.

Steady progress was also achieved in financial reporting and changing prices. In addition to the illustrative disclosures mentioned earlier, the Board issued three Statements on specialized assets inflation provisions—for mining and oil and gas, timberlands and growing timber, and income-producing real estate. The experiment on inflation accounting reporting appears off to a good start.

A list of pronouncements and other documents issued by the FASB during the last six months follows:

**FASB Statements of Concepts issued:**

- No. 3 — *Elements of Financial Statements of Business Enterprises* (December 1980) (see p. 10)
- No. 4 — *Objectives of Financial Reporting by Nonbusiness Organizations* (December 1980) (see p. 15)

**FASB Statements issued:**

- No. 38 — *Accounting for Preacquisition Contingencies of Purchased Enterprises* (September 1980) (see p. 45)
- No. 39 — *Financial Reporting and Changing Prices: Specialized Assets — Mining and Oil and Gas* (October 1980) (see p. 46)
- No. 40 — *Financial Reporting and Changing Prices: Specialized Assets — Timberlands and Growing Timber* (November 1980) (see p. 48)
- No. 41 — *Financial Reporting and Changing Prices: Specialized Assets — Income-Producing Real Estate* (November 1980) (see p. 48)
- No. 42 — *Determining Materiality for Capitalization of Interest Cost* (November 1980) (see p. 49)

No. 43 — *Accounting for Compensated Absences* (November 1980) (see p. 49)

No. 44 — *Accounting for Intangible Assets of Motor Carriers* (December 1980) (see p. 51)

**Interpretation issued:**

No. 33 — *Applying FASB Statement No. 34 to Oil and Gas Producing Operations Accounted for by the Full Cost Method* (August 1980) (see p. 63)

**Technical Bulletins issued:**

80-1 — *Early Extinguishment of Debt Through Exchange for Common or Preferred Stock* (December 19, 1980)

80-2 — *Classification of Debt Restructurings by Debtors and Creditors* (December 19, 1980)

**Discussion Memorandum issued:**

*Reporting Funds Flows, Liquidity, and Financial Flexibility* (December 15, 1980) (see p. 77)

**Exposure Drafts issued:**

- *Foreign Currency Translation* (August 28, 1980) (see p. 67)
- *Disclosure of Interest Rate Futures Contracts and Forward and Standby Contracts* (November 14, 1980) (see p. 69)
- *Disclosure of Obligations: Disclosure of Unconditional Obligations* (November 14, 1980) (see p. 69)
- *Accounting for Franchise Fee Revenues* (December 1, 1980) (see p. 71)

**Proposed Interpretations issued:**

- *Accounting by Oil and Gas Producing Companies for the Tax Benefits of Percentage Depletion*, an interpretation of FASB Statement No. 19 (July 31, 1980) (see p. 72)
- *Disclosure of Obligations: Disclosure of Indirect Guarantees of Indebtedness of Others* (November 14, 1980) (see p. 72)
- *Accounting for Exploratory Wells in Progress at the End of a Period* (November 26, 1980) (see p. 73)
- *Criteria for Applying the Equity Method of Accounting for Investments in Common Stock* (December 19, 1980) (see p. 73)

**Special Report issued:**

*Examples of the Use of FASB Statement No. 33, Financial Reporting and Changing Prices* (November 1980)

**Research Reports issued:**

- *Reporting of Service Efforts and Accomplishments* (November 1980) (see p. 85)
- *Recognition of Contractual Rights and Obligations* (December 1980) (see p. 87)



## STATEMENTS OF FINANCIAL ACCOUNTING CONCEPTS ISSUED

### Purpose and Authority

- The purpose of the series on concepts is to set forth objectives and fundamentals on which financial accounting and reporting standards will be based.
  - The objectives identify the goals and purposes of financial reporting.
  - The fundamentals are the underlying concepts of financial accounting.
    - Concepts guide the selection of transactions, events, and circumstances to be accounted for, their measurement and recognition, and the means of summarizing and communicating them to interested parties.
- Statements of Financial Accounting Concepts do not establish generally accepted accounting principles and, therefore, are not intended to invoke the application of Rule 203 or 204 of the AICPA *Rules of Conduct of the Code of Professional Ethics*.
- Pending reexamination of its pronouncements, as well as those of predecessor standard-setting bodies, and existing accounting practices in the light of the concepts developed, Statements of Financial Accounting Concepts do not require or justify:
  - A change in existing accounting principles.
  - Amendment, modification, or interpretation of existing standards of the Board and predecessor bodies.
  - A change in existing accounting and reporting practices based on a personal interpretation of the objectives and concepts.

### No. 1 — *Objectives of Financial Reporting by Business Enterprises* (November 1978)

- Establishes the objectives of general purpose external financial reporting by business enterprises.
  - Does not conclude that the uses and objectives of financial reporting by other kinds of entities are, or should be, the same as or different from those of business enterprises.
  - Contains no conclusions about matters such as the identity, number or form of financial statements, the attributes to be measured, or the unit of measure to be used.
  - Objectives pertain to financial reporting, and are not restricted to information communicated by financial statements.
    - Financial reporting includes not only financial statements but also other means of communicating information that relates, directly or indirectly, to the information provided by the accounting system.
  - Objectives are affected by the economic, legal, political, and social environment in the United States.
  - Objectives are also affected by characteristics and limitations of the information that financial reporting, and particularly financial statements, can provide.
    - The information is primarily financial in nature — it is generally quantified and expressed in units of money.

- The information is often limited by constraints inherent in procedures, such as verification, that are commonly used to enhance the reliability or objectivity of the information.
  - The information pertains to individual business enterprises, which may comprise two or more affiliated entities, rather than to industries or an economy as a whole.
  - The information often results from approximations of the financial effects of transactions and events, rather than exact measures. Numerous estimates, classifications, summarizations, judgments, and allocations are involved in the measurement process.
  - The information largely reflects the financial effects of transactions and events that have already happened.
  - Financial reporting is but one source of information needed to make economic decisions about business enterprises.
  - Financial information involves a cost to provide and use.
- The objectives stem primarily from the informational needs of external users who lack the authority to prescribe the financial information they want from the enterprise and must use the information that management communicates to them.
- For pragmatic reasons, the objectives are focused on information for investment and credit decisions.
- Objectives
- Financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit and similar decisions.
    - The information should be comprehensible to those who have a reasonable understanding of business and economic activities and are willing to study the information with reasonable diligence.
  - Financial reporting should provide information to help present and potential investors and creditors and other users in assessing the amounts, timing, and uncertainty of prospective cash receipts from dividends or interest and the proceeds from the sale, redemption, or maturity of securities or loans.
    - The prospects for those cash receipts are affected by an enterprise's ability to generate enough cash to meet its obligations when due and its other cash operating needs, to reinvest in operations, and to pay cash dividends, and may be affected by investors' and creditors' perceptions about that ability, which affect share market prices.
    - Financial reporting should, therefore, provide information to help investors, creditors, and others assess the amounts, timing, and uncertainty of prospective net cash inflows to the related enterprise.
  - Financial reporting should provide information about the economic resources of an enterprise, the claims to those resources (obligations of the enterprise to transfer resources to other entities and owners' equity), and the effects of transactions, events, and circumstances that change resources and claims to those resources.

- The primary focus of financial reporting is information about an enterprise's performance provided by measures of earnings and its components.
    - Periodic earnings measurement involves relating to periods the benefits from, and the costs of, operations and other transactions, events, and circumstances that affect an enterprise.
    - Accrual accounting generally provides a better indication of enterprise performance than information about current cash receipts and payments.
    - The goal of accrual and deferral of benefits and sacrifices is to relate the accomplishments and the efforts so that reported earnings measure an enterprise's performance during a period.
  - Financial reporting should provide information about how an enterprise obtains and spends cash, about its borrowings and repayment of borrowings, about its capital transactions (including cash dividends and other distributions of enterprise resources to owners), and about other factors that may affect an enterprise's liquidity or solvency.
  - Financial reporting should provide information about how management of an enterprise has discharged its stewardship responsibility to owners (stockholders) for the use of enterprise resources entrusted to management.
    - Earnings information is commonly the focus for assessing management's stewardship or accountability.
    - Financial reporting and financial statements usually cannot, and do not, separate management performance from enterprise performance.
  - Financial reporting should include explanations and interpretations to help users understand financial information provided.
- The objectives leave unanswered the following topics which are to be the subject of other Statements of Financial Accounting Concepts:
- The identity, number, and form of financial statements.
  - Elements of financial statements and their recognition, measurement and display.
  - Information that should be provided by other means of financial reporting.
  - Qualitative characteristics such as relevance, reliability and other criteria for evaluating and selecting accounting information.

## **No. 2 – Qualitative Characteristics of Accounting Information (May 1980)**

- The characteristics or qualities of accounting information discussed in this Statement are the ingredients that make the information useful and are the qualities to be sought when accounting choices are made.
- Although the qualities of accounting information discussed relate primarily to business enterprises, the Board has tentatively concluded that similar qualities also apply to accounting information reported by nonbusiness organizations.
  - Accounting choices are made at two levels:
    - Accounting choices are made by the Board or other agencies that have the power to require enterprises to report in some particular way.



- Accounting choices are also made at the level of the individual enterprise where there are alternative methods of accounting for which no standard has been promulgated, or a choice exists between ways of implementing a standard.
- The central role of financial reporting in investment, credit, and similar decisions makes it essential that accounting information possess those qualities that render it useful for decision making.
  - Objectives oriented more toward stewardship are also concerned with decisions.
    - The broader stewardship use of accounting, which is concerned with the efficiency, effectiveness and integrity of the steward, helps stockholders or other financially interested parties evaluate the management of an enterprise.
  - Appraisal of management's stewardship is a factor in stockholder assessments of the prospects for their investments.
  - This view of stewardship use of accounting information does not diminish its importance, nor does it elevate the predictive value of accounting information above its confirmatory value.
- The characteristics of accounting information that make it a desirable commodity can be viewed as a hierarchy of qualities, with usefulness for decision making the most important.
  - The primary qualities are that accounting information be relevant and reliable.
    - Relevant information must be timely and it must have predictive value or feedback value or both.
    - Reliable information must have representational faithfulness and it must be verifiable and neutral.
  - Comparability, including consistency, is a secondary quality that interacts with relevance and reliability to contribute to the usefulness of accounting information.
  - Two constraints (primarily quantitative rather than qualitative) are:
    - To be useful and worth providing, the benefits of accounting information should exceed its cost.
    - All qualities are subject to a materiality threshold.
  - The hierarchy does not assign priorities among qualities.
    - The relative weight to be given to different qualities must vary according to circumstances.
  - Understandability of accounting information is governed by a combination of user characteristics and characteristics inherent in the information.
  - The Statement discusses trade-offs between characteristics applicable to kinds of decisions and to groups of users of accounting information.
- Relevance is the capacity of accounting information to make a difference in a decision by helping users to form predictions about the outcomes of past, present, and future events, or the capacity to confirm or correct prior expectations.

- Predictive value is an important consideration in distinguishing relevant from irrelevant accounting information.
- Accounting information can also make a difference by confirming or correcting decision makers' earlier expectations.
- Timeliness is an ancillary aspect of relevance.
  - Gains in relevance that come with increased timeliness may entail sacrifices of other desirable characteristics of accounting information, as, for example, precision.
- Reliability is the quality of accounting information that assures the information is reasonably free from error and bias and faithfully represents what it purports to represent.
  - Reliability of accounting information stems from two characteristics, representational faithfulness and verifiability.
    - Representational faithfulness is the correspondence or agreement between a measure or description and the phenomenon it purports to represent.
      - Accounting, of necessity, reflects degrees of representational faithfulness.
      - Reliability does not imply certainty or precision.
      - Representational faithfulness requires freedom from bias, both in the measurer and in the measurement method.
      - Completeness of information also affects its relevance.
    - Verifiability, the second characteristic, contributes to reliability because verification implies consensus; it provides a significant degree of assurance that accounting measures represent what they purport to represent.
      - Verification does not guarantee that the information has a high degree of representational faithfulness.
      - A measure with a high degree of verifiability is not necessarily relevant to the decision for which it is intended.
  - The role of conservatism in accounting is reduced to the recognition that uncertainties inherent in business situations necessitate prudent reactions and consideration of all the risks.
  - Conservatism in financial reporting should no longer connote deliberate, consistent understatement of net assets and profits.
  - Neutrality interacts with representational faithfulness and verifiability to affect the usefulness of accounting information.
    - Neutrality means, either in formulating or implementing standards, that the primary concern should be the relevance and reliability of the accounting information that results, not the effect that the new rule may have on a particular interest.
    - For a standard to be neutral, it is not necessary that it treat everyone alike in all respects.
      - A standard could treat small enterprises differently than large enterprises without having its neutrality impugned.
    - The Board recognizes, however, that standard-setting authority must be alert to the economic impact of the standards it promulgates.

- A markedly unexpected effect on business behavior may point to an unforeseen deficiency in a standard in the sense that it does not result in the faithful representation of economic phenomena.
- Reliability and relevance often impinge on each other, creating a need for trade-offs.
- Comparability is a quality of the relationship between two or more pieces of accounting information that enables users to identify similarities in, and differences between, two sets of economic phenomena.
  - Comparison is normally a quantitative assessment of the common characteristics.
  - Accounting information about an enterprise gains greatly in usefulness if it can be compared with similar information about other enterprises and with similar information about the same enterprise for some other period or some other point in time.
    - Noncomparability arises because of:
      - Differences in inputs and classification, such as FIFO-LIFO inventory methods.
      - Ill-chosen or incomplete data inputs that fail the test of reliability in terms of representational faithfulness.
  - Greater comparability is not attained by making unlike things look alike.
  - Consistent use of accounting principles is essential to comparability over time.
    - When a change to a preferable method occurs, disclosure of the effect of the change of method contributes to comparability.
- Materiality is not a primary characteristic, but it is considered in relation to the other qualitative characteristics, especially relevance and reliability.
  - Materiality judgments are primarily quantitative in nature.
  - Omissions or misstatements of an item in a financial report are material if, in the light of surrounding circumstances, the magnitude of the item is such that it is probable that the judgment of a reasonable person relying upon the report would have been changed or influenced by the inclusion or correction of the item.
  - The Board's present position is that no general standards of materiality could be formulated to take into account all the considerations that enter into an experienced human judgment.
    - This position is not intended to imply that quantitative guidance on materiality of specific items may not, appropriately, be written into the Board's standards from time to time.
- Ultimately, a standard-setting body has to do its best to meet the needs of society as a whole when it promulgates a standard that sacrifices one quality for another; it must also be aware constantly of the calculus of costs and benefits.
  - Although it is unlikely that significantly improved means of measuring benefits will become available in the foreseeable future, the Board cannot cease to be concerned about the cost-effectiveness of its standards.

### **No. 3 – *Elements of Financial Statements of Business Enterprises* (December 1980)**

- Defines ten interrelated elements of financial statements of business enterprises that are directly related to measuring performance and status of an enterprise.

- Definitions are concerned with the essential characteristics of items that qualify as elements.
  - All matters of recognition, measurement, and display have purposely been separated from the definitions of elements.
    - To be included in a particular set of financial statements, an item must not only qualify under the definition of an element, but must also meet criteria for recognition and have the relevant attribute that is capable of reasonably reliable measurement or estimate.
    - Elements of financial statements are accounted for and included in financial statements by the use of accrual accounting procedures. Accrual accounting and related concepts are, therefore, significant not only for defining elements of financial statements but also for understanding and considering other aspects of the Conceptual Framework for financial accounting and reporting.
- Most of the definitions are expected to apply as well to organizations other than business enterprises.
  - Assets and liabilities are common to all organizations.
  - Equities, revenues, expenses, gains and losses also fit both business and nonbusiness organizations.
  - Investments by owners, distributions to owners, and comprehensive income may not be relevant to nonbusiness organizations.
  - Other elements, not needed by business enterprises, may be needed by nonbusiness entities.
- Financial statements of both business enterprises and nonbusiness organizations may have additional elements.
  - Other possible elements are not addressed, but other phases of the Conceptual Framework project may define additional elements as needed.
- Elements of financial statements are financial representations of an enterprise's resources, the claims to or interests in those resources, and the changes therein from transactions and other events and circumstances that result in changes in those resources and claims.
- The ten elements are of two different kinds or classes:
  - Assets, liabilities, and equity describe levels or amounts of resources or claims to resources at a moment of time.
  - All other seven elements describe effects of transactions and other events and circumstances that affect an enterprise during intervals of time (periods); these include:
    - Comprehensive income and its components—revenues, expenses, gains, and losses.
    - Investments by owners and distribution to owners.
  - The relations between the two classes of elements are sometimes collectively referred to as "articulation", that is, they result in sets of two or more financial statements that are fundamentally interrelated so that statements that show elements of the first class depend on statements that show elements of the second class, and vice versa.
- Assets are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.

- An asset has three essential characteristics:
  - It embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows.
  - The enterprise can obtain the benefit and control others' access to it.
    - Legal enforceability of a claim to the benefit is not a prerequisite for a benefit to qualify as an asset if its receipt by the enterprise is otherwise probable.
  - The transaction or other event giving rise to the enterprise's right to or control of the benefit has already occurred.
- Once acquired, an asset continues as an asset of the enterprise until the enterprise collects it, transfers it to another entity, or uses it, or some other event or circumstance destroys the future benefit or removes the enterprise's ability to obtain it.
- Valuation accounts that reduce or increase the carrying amount of an asset are sometimes found in financial statements; these are part of the related assets and are neither assets in their own right nor liabilities.
- Liabilities are probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.
  - A liability has three essential characteristics:
    - It embodies a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand.
    - The duty or responsibility obligates a particular enterprise, leaving it little or no discretion to avoid the future sacrifice.
      - The existence of a legally enforceable claim is not a prerequisite for an obligation to qualify as a liability if the future payment of cash or other transfer of assets to settle the obligation is otherwise probable.
    - The transaction or other event obligating the enterprise has already happened.
  - Once incurred, a liability continues as a liability of the enterprise until the enterprise settles it, or another event or circumstance discharges it or removes the enterprise's responsibility to settle it.
- Equity is the residual interest in the assets of an entity that remains after deducting its liabilities.
  - In a business enterprise, the equity is the ownership interest (owners' equity).
- Investment by owners are increases in net assets of a particular enterprise resulting from transfers to it from other entities of something valuable to obtain or increase equity (ownership interests).
  - That which is received includes most commonly assets, but may also include services or satisfaction or conversion of liabilities of the enterprise.
  - Investments by owners increase equity (ownership interests).
- Distributions to owners are decreases in net assets of a particular enterprise resulting from transferring assets, rendering services, or incurring liabilities by the enterprise to owners.
  - Distributions to owners decrease equity (owners' interest).

- When dividends are declared, the enterprise incurs a liability to transfer assets to owners in the future, resulting in equity being reduced and liabilities increased.
  - Reacquisition by an entity of its own equity securities by transferring assets or incurring liabilities to owners is a distribution to owners.
- Comprehensive income is the change in equity (net assets) of an enterprise during a period from transactions and other events and circumstances from nonowner sources. It includes all changes in equity during a period except those resulting from investment by owners and distributions to owners.
  - Over the life of a business enterprise, its comprehensive income equals the net of its cash receipts and cash outlays (excluding cash investments by owners and cash distributions to owners).
  - Comprehensive income results from:
    - Exchange transactions and other transfers between the enterprise and other entities that are not its owners.
    - The enterprise's productive efforts.
    - Price changes, casualties, and other effects of interaction between the enterprise and its economic, legal, social, political and physical environment.
  - Comprehensive income, as defined, is a return on financial capital as distinguished from a return on physical capital.
    - The major difference between the two capital maintenance concepts is that "holding gains and losses" are included in return on capital under the financial capital concept, but these are called "capital maintenance adjustments" under the physical capital concept and are included directly in equity and are not included in return on capital.
    - The term "earnings" has not been used because it may be used to designate a different concept that is a component part of (narrower or less than) comprehensive income, and earnings, when defined, may be a return on physical capital or may be a return on financial capital.
  - The Board has not as yet chosen between the financial and physical capital maintenance concepts for deciding the meaning and appropriate display of "earnings."
  - Capital maintenance concepts are the subject of another project.
  - Comprehensive income comprises two related but distinguishable types of components:
    - Revenues, expenses, gains and losses.
    - Intermediate components or measures that result from combining revenues, expenses, gains and losses (in effect, subtotals); examples are gross margin, contribution margin, income from continuing operations (pretax and after tax), and operating income.
- Revenues are inflows or other enhancements of assets of an entity or settlements of its liabilities (or a combination of both) during a period from delivering or producing goods, rendering services, or other activities that constitute the entity's ongoing major or central operations.
  - Revenues represent actual or expected cash inflows (or the equivalent) that have occurred or will eventuate as a result of the enterprise's ongoing major or central operations during the period.

- Expenses are outflows or other using up of assets or incurrences of liabilities (or a combination of both) during a period from delivering or producing goods, rendering services, or carrying out other activities that constitute the enterprise's ongoing major or central operations.
  - Expenses represent actual or expected cash outflows (or the equivalent) that have occurred or will eventuate as a result of the enterprise's ongoing major or central operations during the period.
- Gains are increases in equity (net assets) from peripheral or incidental transactions of an entity and from all other transactions and other events and circumstances affecting the entity during a period except those that result from revenues or investments by owners.
- Losses are decreases in equity (net assets) from peripheral or incidental transactions of an entity and from all other transactions and other events and circumstances affecting the entity during a period except those that result from expenses or distributions to owners.
- Items that qualify under the definitions of elements of financial statements and that meet the criteria for recognition and measurement are accounted for and included in financial statements by the use of accrual accounting procedures. Accrual accounting and related concepts include the following processes:
  - Accrual accounting attempts to recognize noncash events and circumstances as they occur; specifically, accrual is the accounting process of recognizing assets, liabilities, and components of comprehensive income for amounts expected to be received or paid, usually in cash, in the future.
  - Deferral is the accounting process of recognizing a liability from a current cash receipt or an asset resulting from a current cash payment, with deferred recognition of components of comprehensive income.
  - Allocation is the accounting process of reducing a liability recorded as a result of a cash receipt by recognizing revenues or reducing an asset recorded as a result of a cash payment recognizing expenses or cost production payment.
  - Realization is the process of converting noncash resources and rights into money and is most precisely used in accounting and financial reporting to refer to sales of assets for cash or claims to cash. The related terms, realized and unrealized, therefore, identify revenues or gains or losses on assets sold and unsold, respectively.
  - Recognition is the process of formally recording or incorporating an item in the financial statements of an entity. Thus, an asset, liability, revenue, expense, gain or loss may be recognized (recorded) or unrecognized (unrecorded). "Realization" and "recognition" are not used as synonyms, as they sometimes are in accounting and financial literature.
- The Board emphasizes that the definitions in this Statement neither require nor presage upheavals in present practice, although they may in time lead to some evolutionary changes in practice or in the ways certain items are viewed.
- The Board expects most assets and liabilities in present practice to continue to qualify as assets or liabilities under the definitions in this Statement.
  - Appendix B gives examples of items that qualify and that do not qualify under the definitions of the Statement.
  - Both the liability method and the net-of-tax method of interperiod income tax allocation are compatible with the definitions of the Statement; however, the deferred method, prescribed by APB Opinion No. 11, *Accounting for Income Taxes*, does not fit the definitions.



#### **No. 4 – Objectives of Financial Reporting by Nonbusiness Organizations (December 1980)**

- Establishes the objectives of general purpose external financial reporting by nonbusiness organizations.
  - Those objectives, together with the objectives set forth in FASB Concepts Statement No. 1, *Objectives of Financial Reporting by Business Enterprises*, will serve as the foundation for an integrated Conceptual Framework for financial accounting and reporting that when completed, will have relevance to all entities.
    - It is not necessary to develop an independent conceptual framework for any particular category of entities.
    - Pending resolution of the appropriate structure for setting financial accounting and reporting standards for state and local governmental units, the Board has deferred a final decision on whether the objectives in this Statement should apply to general purpose external financial reporting of those units.
      - There is no persuasive evidence that the objectives in this Statement are inappropriate for financial reporting by state and local governments.
      - The objectives of general purpose external reporting for government-sponsored entities (for example, hospitals, universities or utilities) engaged in activities that are not unique to government should be similar to those of business enterprises or other nonbusiness organizations engaged in similar activities.
- This Statement focuses on organizations that have predominantly nonbusiness characteristics that heavily influence the operations of the organization.
  - The major distinguishing characteristics of nonbusiness organizations include:
    - Receipts of a significant amount of resources from resource providers who do not expect to receive repayment or economic benefits proportionate to resources provided.
    - Operating purposes that are primarily other than to provide goods and services at a profit or profit equivalent.
    - Absence of defined ownership interests that can be sold, transferred, or redeemed, or that convey entitlement to a share of a residual distribution of resources in the event of liquidation of the organization.
  - These characteristics result in certain types of transactions that are largely or frequently absent in business enterprises such as contributions and grants, and in the absence of certain transactions with owners such as issuing and redeeming stock and paying dividends.
- The line between nonbusiness organizations and business enterprises is not always sharp because the incidence and relative importance of those characteristics in any organization are different.
  - A spectrum of organizations exists – from those with clearly dominant nonbusiness characteristics to those with wholly business characteristics.
    - Examples of organizations that clearly fall outside the focus of this Statement (and thus fall clearly within the focus of FASB Concepts Statement No. 1) include:
      - All investor-owned enterprises.

- Other types of organizations that provide dividends, lower costs, or other economic benefits directly and proportionally to their owners, members or participants. These types of organizations include mutual insurance companies and other mutual cooperative entities.
- Examples of organizations that clearly fall within the focus of this Statement include:
  - Most human service organizations.
  - Churches
  - Foundations
  - Other organizations that receive a significant portion of their financial resources from sources other than the sale of goods and services — such as some private nonprofit hospitals and nonprofit schools.
- Borderline cases are those where organizations possess some of the distinguishing characteristics of nonbusiness organizations, but not others.
  - These include organizations that have no ownership interests but are essentially self-sustaining from fees they charge for goods and services — such as those private nonprofit hospitals and nonprofit schools that receive relatively small amounts of contributions and grants but finance their capital needs largely from service charges.
  - The objectives of FASB Concepts Statement No. 1 may be more appropriate for these organizations.
- General purpose external financial reporting focuses on providing information to meet the common interests of external users who generally cannot prescribe the information they want from an organization.
  - External users include resource providers, such as members, taxpayers, contributors and creditors.
- Financial reporting comprehends financial statements, and extends to other means of communicating information about an organization's resources and obligations.
  - Financial reporting by nonbusiness organizations, however, is limited in its ability to provide direct measures of the quality of goods and services provided in the absence of market-determined exchange prices, or the degree to which they satisfy the needs of service beneficiaries and other consumers.
  - Other means of reporting, such as information that is not expressed in terms of units of money may be needed to understand the significance and to help in assessing the performance of a nonbusiness organization.
  - The information provided by financial reporting largely reflects the effects of transactions and events that have already happened. Governing bodies and managers, however, may use budgets to communicate information about plans or projections.
  - Financial reporting is but one source of information needed by those that make economic decisions about nonbusiness organizations; relevant social, economic and political information about other sources must also be used.
- The objectives of financial reporting for nonbusiness organizations are to provide information useful to present and potential resource providers and other users in:
  - Making rational decisions about the allocation of resources to those organizations.
  - Assessing the services that a nonbusiness organization provides and its ability to continue to provide those services.

- Information on the relation of services provided to resources used helps resource providers and others assess the extent to which the organization is successful in carrying out its service objective.
- Assessing how managers of nonbusiness organizations have discharged their stewardship responsibilities and assessing other aspects of their performance.
  - Managers of an organization are accountable to resource providers and others, not only for custody and safekeeping of an organization's resources, but also for their efficient and effective use.
  - Managers are also accountable for compliance with statutory, contractual, or other limitations.
  - Financial reporting, and especially financial statements, are limited in their ability to separate managers' performance from that of the organization itself.
- Financial reporting should provide the following information about a nonbusiness organization:
  - Economic resources, obligations and net resources, and the effects of transactions, events and circumstances that change resources and interests in those resources.
    - This information also provides direct indications of the cash flow potential of some resources and the cash needed to satisfy many, if not most, obligations.
    - Restrictions on the time and particular purposes for the use of resources is important for assessing the types and level of services an organization is able to provide.
  - Organization performance, which includes:
    - Periodic measurement of the changes in the amount and nature of the net resources.
    - Information about the service efforts and accomplishments of the organization.
      - Information about the service efforts should focus on how the organization's resources (inputs such as money, personnel, and materials) are used in providing different programs or services.
      - Information about service accomplishments in terms of goods or services produced (outputs) and of program results may enhance significantly the value of information provided about service efforts. However, the ability to measure service accomplishments is generally undeveloped.
  - Nature and relation between inflows and outflows of resources. A distinction should be drawn between inflows that change net resources (such as inflows of fees or contributions and outflows for wages and salaries), and those that do not do so (such as borrowings or purchases of buildings).
  - How an organization obtains and spends cash or other liquid resources, about its borrowing and repayment of borrowing, and other factors that may affect an organization's liquidity.
  - Explanations and interpretations to help users understand financial information provided.
- The objectives lead to, but leave unanswered, questions such as the identity, number, and form of financial statements; elements of financial statements and their recognition, measurement, and display; and criteria for determining the reporting entity. Resolving these questions is part of the Conceptual Framework project.

## STATEMENTS OF FINANCIAL ACCOUNTING STANDARDS ISSUED

**No. 1 — *Disclosure of Foreign Currency Translation Information* (December 1973)  
(Superseded by FASB Statement No. 8, *Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements*—October 1975)**

**No. 2 — *Accounting for Research and Development Costs* (October 1974)**

- Requires that research and development costs be charged to expense when incurred.
- Disclosure is required in the financial statements of the total research and development costs charged to expense in each period for which an income statement is presented.
- Additional disclosures are required of regulated enterprises that defer research and development costs for financial statement purposes in accordance with the *Addendum to APB Opinion No. 2*.
- Effective for fiscal years beginning on or after January 1, 1975. Retroactive application by prior period adjustment is required.
- Interpreted by:
  - FASB Interpretation No. 4, *Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method*.
  - FASB Interpretation No. 6, *Applicability of FASB Statement No. 2 to Computer Software*.

**No. 3 — *Reporting Accounting Changes in Interim Financial Statements*, an amendment of APB Opinion No. 28 (December 1974)**

- If a cumulative-effect type accounting change is made in other than the first interim period, the cumulative effect of the change shall not be included in net income of the period of change.
  - Financial information for the pre-change interim periods of the fiscal year in which the change is made shall be restated by applying the newly adopted accounting principle.
  - The cumulative effect of the change on retained earnings at the beginning of the fiscal year shall be included in restated net income of the first interim period.
- Requires some publicly traded companies that make an accounting change in the fourth quarter (but that do not issue a separate fourth quarter report or disclose the quarterly effects of the change in their annual reports) to make the required disclosure in a note to their annual financial statements.
- Effective for accounting changes made in interim periods ending on or after December 31, 1974.

**No. 4 — *Reporting Gains and Losses from Extinguishment of Debt*, an amendment of APB Opinion No. 30 (March 1975)**

- Requires that aggregated gains and losses from extinguishment of debt, net of related income tax effect, be classified as an extraordinary item, irrespective of whether the extinguishment is early, at scheduled maturity, or later.
- Does not apply to gains or losses from cash purchases of debt made to satisfy current or future sinking-fund requirements.

- Applies to regulated enterprises in accordance with the *Addendum to APB Opinion No. 2*.
- Effective for extinguishments occurring after March 31, 1975. Retroactive application is encouraged, but not required.

**No. 5 – *Accounting for Contingencies* (March 1975)**

- An estimated loss from a loss contingency shall be charged to income only if both of the following conditions are met:
  - Information available prior to the issuance of the financial statements indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements.
  - The amount of the loss can be reasonably estimated.
- Loss contingencies not meeting those two conditions require only adequate disclosure when there is at least a reasonable possibility that a loss or an additional loss may have been incurred.
- “Self-insurance” and “catastrophe reserves” *do not* meet the above conditions.
- General or unspecified business risks (such as are provided for in reserves for contingencies) do not meet the conditions for accrual.
- Gain contingencies should not be credited to income because to do so would recognize income prior to realization.
- The Statement applies to regulated enterprises in accordance with the *Addendum to APB Opinion No. 2*.
- Effective for fiscal years beginning on or after July 1, 1975. Earlier application is encouraged. A change in accounting principle resulting from compliance with the Statement shall be reported in accordance with APB Opinion No. 20. The cumulative effect of the change on retained earnings at the beginning of the year in which the change is made shall be included in the net income of the year of change (“catch-up” adjustment).
- Amended by FASB Statement No. 11, *Accounting for Contingencies—Transition Method*.
- Interpreted by FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss*.

**No. 6 – *Classification of Short-Term Obligations Expected To Be Refinanced*, an amendment of ARB No. 43, Chapter 3, Section A (May 1975)**

- Certain short-term obligations shall be excluded from current liabilities if the enterprise intends to refinance the obligations on a long-term basis and the ability to consummate refinancing is demonstrated by:
  - The post-balance-sheet-date issuance of a long-term obligation or equity securities, or
  - A financing agreement entered into before the balance sheet is issued, and
    - The agreement does not expire within one year (or operating cycle) from the balance sheet date, and is not cancellable by the lender,
    - No violation of any provision in the financing agreement exists, and
    - The lender is financially capable of honoring the agreement.
- Adequate disclosure of the agreement should be made.

- Effective as of December 31, 1975. Reclassification in financial statements for periods ending prior to December 31, 1975 is permitted but not required.
- Interpreted by FASB Interpretation No. 8, *Classification of a Short-Term Obligation Repaid Prior to Being Replaced by a Long-Term Security*.

**No. 7 — Accounting and Reporting by Development Stage Enterprises (June 1975)**

- Defines a development stage company as one that is devoting substantially all of its efforts to establishing a new business, and either has not begun its planned principal operations or has started such operations but has not had significant revenue from them.
- No special accounting is applicable to development stage companies, subsidiaries, divisions and other components, but the company should be identified as being in the development stage and certain additional disclosures should be given about cumulative development stage costs from inception.
- Effective for fiscal periods beginning on or after January 1, 1976. Earlier application is encouraged.
  - After the effective date, statements for periods prior to the effective date shall be re-stated; any adjustments that may be necessary shall be accounted for by prior period adjustment.
- Interpreted by FASB Interpretation No. 7, *Applying FASB Statement No. 7 in Financial Statements of Established Operating Enterprises*.

**No. 8 — Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements (October 1975) (Statement No. 8 is being revised. A new Exposure Draft was issued on August 28, 1980, and the final Statement is expected in 1981. We expect required application for 1982 financial reports. Until a new Standard is issued, Statement No. 8 continues in full force as GAAP.)**

- Specifies that, before translation, foreign financial statements that are to be included by consolidation, combination, or the equity method in an enterprise's financial statements must be conformed to U.S. generally accepted accounting principles.
- Provides a method of translation that is similar to the monetary-nonmonetary method heretofore used in practice and the temporal method described in Accounting Research Study No. 12.
  - Foreign currency *transactions* (other than forward exchange contracts) should be translated as follows:
    - Cash and amounts receivable or payable at the balance sheet date should be translated at the current rate.
    - Assets carried at current market value stated in a foreign currency shall be translated at the current rate.
    - All other amounts should be translated at the rate in effect at the transaction date (historical rate).
    - Unperformed forward exchange contracts should be translated at the current rate.
  - Foreign currency *financial statements* should be translated as follows:
    - Cash and amounts receivable and payable should be translated at the current rate.

- Other assets and liabilities (including deferred debits and credits) should be translated at:
  - Historical rates for those accounts carried at historical cost (past exchange prices). Averaging and approximation may be necessary when applying historical rates.
  - Current rates for those accounts carried at current prices (market, replacement), or future prices (future exchanges).
  - Deferred taxes, under certain circumstances, may be translated at the current rate.
- Revenue and expenses should be translated at rates that would approximate the rate in effect had the individual transactions been translated into dollars at the date incurred (averages), except for revenue and expense items that relate to balance sheet items translated at historical rates (such as depreciation).
- Gains or losses resulting from the required translation procedures must be recognized as current income and not deferred, except that gains or losses on a forward exchange contract should be deferred when the contract is intended as a hedge of an identifiable foreign currency commitment.
- Disclosure of the aggregate exchange gain or loss included in determining net income for the period is required. If practicable, effects of exchange rate changes on revenue and earnings, other than exchange gains or losses, should be described and quantified.
- Financial statements may not be adjusted for a rate change that occurs after the date of the financial statements, although disclosure may be necessary if the rate change and its effect are significant.
- Effective for fiscal years beginning on or after January 1, 1976. Earlier application is encouraged.
  - Financial statements for periods before the effective date should be restated, if practicable, to conform to the Statement. If restatement for all prior periods presented is not practicable, then the cumulative effect on retained earnings at the beginning of the earliest period restated shall be included in determining the net income of that period in accordance with APB Opinion No. 20.
- Amended by FASB Statement No. 20, *Accounting for Forward Exchange Contracts*.
- Interpreted by:
  - FASB Interpretation No. 15, *Translation of Unamortized Policy Acquisition Costs by a Stock Life Insurance Company*.
  - FASB Interpretation No. 17, *Applying the Lower of Cost or Market Rule in Translated Financial Statements*.

**No. 9 — Accounting for Income Taxes—Oil and Gas Producing Companies**, an amendment of APB Opinions Nos. 11 and 23 (October 1975) (Superseded by FASB Statement No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies*—December 1977)

**No. 10 — Extension of “Grandfather” Provisions for Business Combinations**, an amendment of APB Opinion No. 16 (October 1975)

- The five-year limitation in the grandfather provisions contained in paragraph 99 of APB Opinion No. 16 and in certain AICPA Accounting Interpretations is eliminated.
- Effective on November 1, 1975.



**No. 11 — *Accounting for Contingencies—Transition Method*, an amendment of FASB Statement No. 5 (December 1975)**

- Specifies that for fiscal years beginning on or after July 1, 1975, FASB Statement No. 5 shall be applied retroactively to earlier periods if presented. If restatement for all prior periods presented is not practicable, the cumulative effect on the retained earnings at the beginning of the earliest period restated shall be included in determining the net income of that period in accordance with APB Opinion No. 20.
- Effective retroactively to the effective date of FASB Statement No. 5 except that financial statements issued prior to January 1, 1976 that were based on the original transition requirements in paragraph 20 of FASB Statement No. 5 are not required to comply with FASB Statement No. 11.

**No. 12 — *Accounting for Certain Marketable Securities* (December 1975)**

- Specifies that the carrying amount of a marketable equity securities portfolio shall be the lower of its aggregate cost or market value, determined at the balance sheet date.
  - The amount by which aggregate cost of the portfolio exceeds market value shall be accounted for as a valuation allowance.
- All marketable equity securities classified as current in the balance sheet shall be treated as a single portfolio for the consolidated entity; likewise, all marketable equity securities classified as noncurrent shall be treated as a separate portfolio for the consolidated entity. In the case of unclassified balance sheets, marketable equity securities shall be considered as noncurrent assets. The portfolios of marketable equity securities owned by an entity accounted for by the equity method (subsidiary or investee) shall not be combined with the portfolios of the consolidated entities.
- If there is a change in the classification of marketable equity securities, the lower of cost or market at the date of change shall become the new cost basis and any difference should be treated as a realized loss.
- All realized gains and losses and all changes in the valuation for a marketable equity securities portfolio included in current assets shall be included in the determination of net income of the period in which they occur. Accumulated changes in the valuation allowance for a portfolio included in noncurrent assets or in an unclassified balance sheet shall be included in the equity section of the balance sheet.
- Disclosure is required of aggregate cost and market value (for each segregated portfolio), gross unrealized gains and gross unrealized losses (for each portfolio), and net realized gain or loss included in the determination of net income. Other disclosures are also called for.
- Special provisions are given for certain industries having specialized accounting practices.
- The Statement does not apply to not-for-profit organizations, pension funds, and mutual life insurance companies.
- Effective for fiscal periods and interim periods ending on or after December 31, 1975.
  - If the initial application of the Statement requires the establishment of a valuation allowance for the current portfolio, the amount thereof shall be included in the determination of net income for that period. Similarly, in the initial establishment of a valuation allowance for the noncurrent portfolio, the amount thereof shall be reflected separately in stockholders' equity as of the end of that fiscal period.

– Interpreted by:

- FASB Interpretation No. 10, *Application of FASB Statement No. 12 to Personal Financial Statements*.
- FASB Interpretation No. 11, *Changes in Market Value After the Balance Sheet Date*.
- FASB Interpretation No. 12, *Accounting for Previously Established Allowance Accounts*.
- FASB Interpretation No. 13, *Consolidation of a Parent and Its Subsidiaries Having Different Balance Sheet Dates*.
- FASB Interpretation No. 16, *Clarification of Definitions and Accounting for Marketable Equity Securities That Become Nonmarketable*.

**No. 13 – Accounting for Leases** (November 1976) (Statement No. 13 has been amended and interpreted extensively. See the next item for an integration of Statement No. 13 and its various amendments and interpretations.)

**No. 13 – Accounting for Leases**, as amended and interpreted through May 1980 (May 1980)

– Incorporates the standards section of Statement No. 13, *Accounting for Leases* as amended and interpreted by seven Statements and six Interpretations.

Amendments:

- Statement No. 17 – *Accounting for Leases – Initial Direct Costs*
- Statement No. 22 – *Changes in the Provisions of Lease Agreements Resulting From Refundings of Tax-Exempt Debt*
- Statement No. 23 – *Inception of the Lease*
- Statement No. 26 – *Profit Recognition on Sales-Type Leases of Real Estate*
- Statement No. 27 – *Classification of Renewals or Extensions of Existing Sales-Type or Direct Financing Leases*
- Statement No. 28 – *Accounting for Sales With Leasebacks*
- Statement No. 29 – *Determining Contingent Rentals*

Interpretations:

- Interpretation No. 19 – *Lessee Guarantee of the Residual Value of Leased Property*
- Interpretation No. 21 – *Accounting for Leases in a Business Combination*
- Interpretation No. 23 – *Leases of Certain Property Owned by a Governmental Unit or Authority*
- Interpretation No. 24 – *Leases Involving Only Part of a Building*
- Interpretation No. 26 – *Accounting for Purchase of a Leased Asset by the Lessee During the Term of the Lease*
- Interpretation No. 27 – *Accounting for a Loss on a Sublease*

– The Board did not vote on this document because the need for a formal vote on the integration of the components did not exist; each of the pronouncements was formally approved at the time of adoption.

- This document establishes standards of financial accounting and reporting for leases by lessees and lessors.
  - A lease is defined as an agreement conveying the right to use property, plant, or equipment usually for a stated period of time.
    - Included within the definition are contracts such as a “heat supply contract” for nuclear fuel.
    - Does not include agreements that are limited to contracts for services.
    - Does not apply to lease agreements for rights to explore for or to exploit natural resources.
    - Does not apply to licensing agreements for items such as motion picture films, patents, and copyrights.
    - Applies to regulated enterprises in accordance with the provisions of the Addendum to APB Opinion No. 2, *Accounting for the “Investment Credit”*.
  - Definitions are provided for the terms used in this document such as bargain purchase option, lease term, minimum lease payments, executory costs, and the like.
- Leases are classified as follows:
  - Lessee:
    - Capital leases
    - Operating leases
  - Lessor:
    - Sales-type leases
    - Direct financing leases
    - Leveraged leases
    - Operating leases
- Criteria for classifying leases:
  - Lessee — A lease is classified as a *capital lease* if at its inception it meets one or more of the following four criteria; otherwise, it shall be classified as an operating lease:
    - The lease transfers ownership of the property to the lessee by the end of the lease term.
    - The lease contains a bargain-purchase option.
    - The lease term is equal to 75 percent or more of the estimated economic life of the leased property. If the beginning of the lease term falls within the last 25 percent of the total estimated economic life of the leased property, including earlier use, this criterion shall not be used.
    - Present value at the beginning of the lease term of the minimum lease payments, excluding that portion representing executory costs to be paid by the lessor, including any profit thereon, equals or exceeds 90 percent of the excess of the fair value of the leased property to the lessor at the inception of the lease over any related investment tax credit retained by the lessor and expected to be realized by him.
  - This criterion is subject to the 25 percent remaining life exception referred to immediately above.

- Lessor shall compute the present value of the minimum lease payments using the interest rate implicit in the lease.
  - Lessee shall use his incremental borrowing rate unless he can learn the implicit rate used by the lessor, and that rate is less than his incremental borrowing rate.
  - Lessor — A lease is classified as a *sales-type lease* or *direct financing lease*, whichever is appropriate, if at the inception of the lease it meets any one of the preceding four criteria and in addition meets both of the following criteria; otherwise it shall be classified as an operating lease:
    - Collectibility is reasonably predictable.
      - The need to subject the receivable to an estimate of uncollectibility does not violate the collectibility criterion.
    - No important uncertainties surround the amount of unreimbursable costs yet to be incurred by the lessor.
      - The necessity to estimate executory costs to be paid by the lessor shall not constitute an important uncertainty.
      - A lease involving real estate that would otherwise be classified as a sales-type lease giving rise to a manufacturer's or dealer's profit shall be classified as an operating lease unless at the beginning of the lease term it also meets the requirements of a sale with full and immediate profit recognition under the AICPA Industry Accounting Guide, *Accounting for Profit Recognition on Sales of Real Estate*.
  - A change in the provisions of a lease, other than by renewing the lease or extending its term, that would have resulted in a different classification had those terms been in effect at the inception of the lease, creates a new agreement over its remaining term for classification purposes.
    - Changes in estimates, such as economic life or residual value, or in circumstances, such as default by lessee, shall not give rise to a new classification.
- Accounting and Reporting
- Lessees
    - Lessee records a capital lease as an asset and an obligation at an amount equal to the present value, at the beginning of the lease term, of minimum lease payments during the lease term exclusive of executory costs together with any profit thereon.
    - If the amount so determined exceeds the fair value of the leased property at the inception of the lease, the amount recorded as the asset and obligation shall be the fair value.
    - The discount rate to be used in determining present value is as discussed above under criteria for classifying a lease.
    - Except for certain provisions with respect to leases involving land, the asset recorded under a capital lease shall be amortized as follows:
      - Leases capitalized under the transfer of title by the end of the lease term or existence of a bargain purchase option criterion shall be amortized over the life of the asset as if owned. Otherwise, the asset shall be amortized over the lease term.
      - If amortized over the lease term, the lease shall be amortized to its expected value to the lessee, if any.

- Special accounting provisions apply in the following cases:
  - The lease contains a residual guarantee by the lessee or a penalty for failure to renew the lease at the end of the lease term and a renewal or extension of the lease term renders the guarantee or penalty inoperative.
  - There are no guarantees or penalties and there is a change in the provisions of a lease, a renewal or extension of an existing lease, or a termination of a lease prior to the expiration of the lease term.
  - Prior to the expiration of the lease term, a change in the provisions of a lease results from a refunding by the lessor of tax-exempt debt, including an advance refunding, in which the perceived economic advantages of the refunding are passed through to the lessee and the revised agreement is classified as a capital lease by the lessee.
- Rentals on operating leases shall be charged to expense over the lease term as it becomes payable.
  - If rental payments are not made on a straight-line basis, rental expense shall, nevertheless, be recognized on a straight-line basis unless another basis is more representative of asset-use benefit.
- Disclosures with regard to capital leases in the financial statements or in footnotes include: gross assets recorded, classified by nature or function; future minimum lease payments at the balance sheet date, in the aggregate and for each of the five succeeding fiscal years, with certain deductions for executory costs and imputed interest; total of minimum sublease rentals to be received under noncancellable subleases, total contingent rentals actually incurred; and assets recorded under capital leases and the accumulated amortization thereon, and the related obligations including current and noncurrent status.
- Disclosure for operating leases having initial or remaining noncancellable lease terms in excess of one year include future minimum rental payments in the aggregate and for each of the five succeeding years, and total minimum rentals to be received in the future under noncancellable subleases.
- Disclosure for all operating leases includes rental expense with separate amounts for minimum rentals, contingent rentals, and subrentals.
- A general description of the lessee's leasing arrangements is required including basis of contingent rentals, renewal terms, restrictions.
- Lessors
  - For sales-type leases, the gross investment in the lease is the minimum lease payments during the lease term, net of executory costs together with any profit thereon, plus the unguaranteed residual value accruing to the benefit of the lessor. The residual value shall not exceed the amount estimated at the inception of the lease.
  - The difference between the gross investment and the sum of the present values of the two components of the gross investment shall be recorded as unearned income.
    - The discount rate shall be the interest rate implicit in the lease.
  - The net investment in the lease is the gross investment less the unearned income.
  - The unearned income shall be amortized on an interest basis.
  - The net investment shall be classified as current or noncurrent, as appropriate.
  - The present value of the minimum lease payments, net of executory costs, discounted at the interest rate implicit in the lease shall be recorded as the sales price.

- The cost or carrying amount, if different, of the leased property, plus any initial direct costs, less the present value of the unguaranteed residual value accruing to the benefit of the lessor shall be charged against income in the same period.
- Special rules are provided for the following:
  - Annual review of estimated residual values.
  - Accounting where leases contain a residual guarantee or a penalty for failure to renew the lease.
  - Changes in lease provisions, renewal or extension of an existing lease, and termination of a lease prior to the expiration of its term.
  - Changes resulting from the refunding by the lessor of tax-exempt debt, including advance refunding.
- Accounting for direct financing leases is essentially similar to that described for sales-type leases except that no profit on sales is recognized.
- Accounting for operating leases requires that the leased property be included with or near property, plant, and equipment in the balance sheet. Depreciation shall follow the lessor's normal policies. Rent shall be reported over the lease term as it becomes receivable. However, if rentals vary from straight-line, the income shall be recognized on a straight-line basis unless another approach is more representative of the diminution of use benefit. Initial direct costs shall be deferred and allocated over the lease term in proportion to the recognition of rental income. Initial direct costs may be charged to expense as incurred if the effect is not materially different from the deferral method.
- In participation by third parties, the sale or assignment of a lease, or of property subject to a lease, that was accounted for as a sales-type or direct financing lease shall not negate the original accounting treatment. The sale of property subject to an operating lease, or of property that is leased by or intended to be leased by the third party purchaser to another party, shall not be treated as a sale if the seller or any party related to the seller retains substantial risks.
- Disclosures required when leasing is a significant part of the lessor's business activities include the following:
  - For sales-type and direct financing leases:
    - The components of the net investment including future minimum lease payments to be received less executory costs, and accumulated allowance for uncollectible payments, the unguaranteed residual values accruing to the lessor, and unearned income.
    - Future minimum lease payments to be received for each of the five succeeding fiscal years.
    - Total contingent rentals included in income.
    - For direct financing leases only, the amount of unearned income included in income to offset initial direct costs charged against income.
  - For operating leases, the required disclosures include:
    - The cost and carrying amount, if different, of property on lease, or held for leasing, by major classes of property according to nature or function and the related accumulated depreciation.

- Minimum future rentals on noncancellable leases, in the aggregate and for each of the five succeeding fiscal years.
- Total contingent rentals included in income.
- A general description of the lessor's leasing arrangements.
- Special topics include:
  - Leases involving real estate, including land only, land and buildings, equipment as well as real estate, and leases involving only part of a building.
  - Leases between related parties.
  - Sale and leaseback transactions.
  - Accounting and reporting for subleases and similar transactions, including accounting by the original lessor, the original lessee, and the new lessee.
  - Accounting for leases in a business combination.
  - Accounting and reporting for leveraged leases.
- Effective Date and Transition
  - Applies to transactions and lease agreement revisions entered into on or after January 1, 1977 except where made pursuant to the terms of a written commitment made prior to that date. The disclosures called for in the Statement shall be included in financial statements for calendar years or fiscal years ending after December 31, 1976.
  - If the Statement is not applied retroactively, disclosure of the effect on the balance sheet and income statement of retroactive application is required beginning with financial statements for the year ending December 31, 1977 and thereafter until years beginning after December 31, 1980.
  - Financial statements for periods beginning after December 31, 1980 must include retroactive application of the Statement. Financial statements of earlier years presented for comparative purposes are to be restated at least as far back as December 31, 1976.
  - See each amendment or interpretation for its effective date and transition requirements.

**No. 14 — *Financial Reporting for Segments of a Business Enterprise* (December 1976)**

- Annual financial statements and financial statements for interim periods that are expressly described as presenting financial position, results of operations, and changes in financial position in conformity with generally accepted accounting principles shall include certain information relating to:
  - The enterprise's operations in different industries.
  - Its foreign operations.
  - Its major customers.
  - Its export sales.
- Industry segments shall be established by management by:
  - Identifying the individual products and services from which the enterprise derives its revenue.
  - Grouping the services by industry lines into industry segments.



- Selecting the industry segments that are significant with respect to the enterprise as a whole.
  - Reference may be made to outside classification sources such as the Standard Industrial Classification, although none by itself is suitable for purposes of this Statement.
  - Profit centers are the logical starting point for establishing segments.
- Reportable segments are those that satisfy one or more of the following criteria:
  - Contribute 10% or more of the combined revenue.
  - Operating profit or loss is 10% or more of the greater of the:
    - Combined operating profit of all segments that did not incur an operating loss, or
    - Combined operating loss of all segments that did incur an operating loss.
  - Identifiable assets are 10% or more of combined identifiable assets of all segments.
- Reportable segments shall represent at least 75% of the combined revenue from sales to unaffiliated customers of all industry segments.
- Ten segments may be a practical upper limit.
- Information to be presented by segment:
  - Revenue including transfers to other segments.
  - Operating profit or loss (which represents revenue less all direct and allocable operating expenses exclusive of revenue earned at the corporate level, general corporate expenses, interest expense, domestic and foreign income taxes, equity in income of investees, extraordinary items, and the like).
  - Identifiable assets, including direct and jointly-used assets; assets used for general corporate purposes are excluded.
- Other disclosures include details as to depreciation, capital expenditures, equity in income of investees, and the effect of a change in accounting method.
- Foreign operations:
  - In addition to information concerning industry segments, separate information shall be presented at a minimum for an enterprise's foreign operations, either in the aggregate or (if appropriate) by geographic area, if foreign operations contribute 10% or more of consolidated revenue or if the assets identifiable with the foreign operations are 10% or more of consolidated assets.
  - Sales, profit, and asset data to be presented are similar to those to be presented for industry segments.
- Export sales are reportable if exports are 10% or more of total revenue from sales to unaffiliated customers.
- If 10% or more of total enterprise revenue is derived from sales to a single customer, to domestic government agencies in the aggregate, or to foreign governments in the aggregate, that fact and the amount of revenue shall be disclosed.
- Methods of presentation are specified.
- Effective for fiscal years beginning after December 15, 1976 and for interim periods within those fiscal years.

— Amended by:

- FASB Statement No. 18, *Financial Reporting for Segments of a Business Enterprise—Interim Financial Statements*.
- FASB Statement No. 21, *Suspension of the Reporting of Earnings Per Share and Segment Information by Nonpublic Enterprises*.
- FASB Statement No. 24, *Reporting Segment Information In Financial Statements That Are Presented in Another Enterprise's Financial Report*.
- FASB Statement No. 30, *Disclosure of Information About Major Customers*.

**No. 15 —Accounting by Debtors and Creditors for Troubled Debt Restructurings (June 1977)**

- Establishes standards of financial accounting and reporting by the debtor and by the creditor for a troubled debt restructuring.
- A restructuring of a debt constitutes a troubled debt restructuring "if the creditor is compelled by economic or legal considerations related to the debtor's financial difficulties to grant relief to the debtor that cannot meet its obligations on the debt."
  - Debt restructurings that are not troubled debt restructurings would continue to be accounted for under existing principles, including APB Opinion No. 26, *Early Extinguishment of Debt*.
- Troubled debt restructurings are divided into two broad groups:
  - Debtor transfers receivables, real estate, or other assets to the creditor or issues its stock to the creditor to satisfy the creditor's claim.
  - Terms of the debt are modified to defer or reduce the cash payments the debtor is required to make to the creditor.
- Debtors and creditors account for the fair value of assets transferred and equity interests granted.
  - Debtor recognizes a gain and creditor recognizes a loss for the difference between fair value of the consideration transferred and the recorded amount of the debt satisfied.
  - Debtor would also recognize a gain or loss on the assets transferred if their fair values differ from their recorded amounts.
- Modification of the terms of continuing debt call for prospective treatment for the effects of such modifications as reduced interest expense or interest income to maturity, with one exception. If the total amounts to be paid or received (principal and interest) are less than the carrying amount of the payable, the debtor would record a gain and the creditor would record a loss to the extent of the difference. Thereafter, all cash payments should be accounted for as reductions of the carrying amount of debt or receivable, and no interest expense or interest income shall be recognized.
- Disclosure requirements by debtor and creditor are specified.
- Except for certain matters relating largely to disclosure, effective for troubled debt restructurings occurring after December 31, 1977. Certain disclosures in financial statements of creditors are required for fiscal years ending after December 15, 1977. Earlier application is encouraged but not required.

**No. 16 — *Prior Period Adjustments* (June 1977)**

- Restricts prior period adjustments.
- All items of profit and loss recognized during a period, including accruals of estimated losses from loss contingencies, shall be included in the determination of net income for that period except the following which shall be treated as prior period adjustments:
  - Correction of an error of a prior period.
  - Adjustments that result from realization of income tax benefits of preacquisition operating loss carryforwards of purchased subsidiaries.
- Effective for financial statements for fiscal years beginning after October 15, 1977. Earlier application is encouraged but not required. The Statement shall not be applied retroactively to previously issued annual financial statements.

**No. 17 — *Accounting for Leases—Initial Direct Costs*, an amendment of FASB Statement No. 13 (November 1977) (Incorporated in the codification of FASB Statement No. 13, *Accounting for Leases*, May 1980.)**

- Modifies and clarifies the definition of “initial direct costs.”
- Effective for leasing transactions and lease agreement revisions entered into on or after January 1, 1978. The provisions shall be applied retroactively at the same time and in the same manner as the provisions of FASB Statement No. 13 are applied retroactively, except that enterprises that have already applied Statement No. 13 retroactively in published annual financial statements need not apply this Statement retroactively.

**No. 18 — *Financial Reporting for Segments of a Business Enterprise—Interim Financial Statements*, an amendment of FASB Statement No. 14 (November 1977)**

- Eliminates the requirement to disclose segment information in interim-period financial statements.
- Effective December 1, 1977, retroactive to the effective date of FASB Statement No. 14.

**No. 19 — *Financial Accounting and Reporting by Oil and Gas Producing Companies* (December 1977)**

- Requires oil and gas producing companies to use a version of the “successful efforts” method of accounting for costs incurred in searching for and developing oil and gas reserves.
- Among the accounting requirements are the following:
  - Mineral interests in properties are recorded as assets when acquired.
  - All exploration costs except the costs of drilling exploratory wells are charged to expense when incurred.
  - The costs of drilling exploratory wells, including exploratory-type stratigraphic test wells, are capitalized as “construction-in-progress” when incurred, to be charged to expense later if the well is determined not to have found proved reserves or to be reclassified as an amortizable asset if proved reserves are discovered.
    - If producible quantities of reserves are found by a well drilled offshore or in a remote area, but classification of those reserves as proved depends on whether additional exploratory wells find enough additional reserves to justify a major capital expenditure, such as for an offshore production platform or a trunk pipeline, the cost of drilling the well can be deferred as construction-in-progress as long as the additional exploratory drilling is under way or firmly planned.

- After discovery of reserves, costs incurred to drill all development wells, including development-type stratigraphic test wells, are capitalized as amortizable assets.
  - After production begins, the capitalized acquisition, exploration, and development costs relating to reserves that were discovered are amortized, on a unit-of-production basis, as the reserves are produced. For amortization purposes, properties may be grouped in a field under certain conditions.
  - Unproved properties that are held must be reviewed for impairment and, if called for, a loss must be recognized.
- Supersedes FASB Statement No. 9, *Accounting for Income Taxes—Oil and Gas Producing Companies*.
- Comprehensive interperiod tax allocation by the deferred method, as described in APB Opinion No. 11, *Accounting for Income Taxes*, shall be followed by oil and gas producing companies for intangible drilling and development costs and other costs incurred that enter into the determination of taxable income and pretax accounting income in different periods.
  - The possibility that statutory depletion in future periods will reduce or eliminate the amount of income taxes otherwise payable shall not be taken into account.
- Disclosures required include quantities of proved reserves and proved developed reserves of oil and gas at the beginning and end of each year, and changes therein during the year. Disclosure is also required of costs for property acquisitions, exploration, development, and production or lifting.
- Effective for financial statements for fiscal years beginning after December 15, 1978 and for interim periods within those fiscal years. Accounting changes adopted to conform to the provisions of the Statement should be made retroactively by restating the financial statements of prior periods.
- Amended by FASB Statement No. 25, *Suspension of Certain Accounting Requirements for Oil and Gas Producing Companies*.

**No. 20 — Accounting for Forward Exchange Contracts, an amendment of FASB Statement No. 8 (December 1977)**

- Amends paragraph 27 of FASB Statement No. 8 to provide a transition period during which an enterprise may enter into a forward contract to hedge an existing commitment that was entered into before the effective date of FASB Statement No. 8. For purposes of determining compliance with the conditions for deferral of a gain or loss, such a forward contract would be considered to have met the conditions of paragraph 27(a) if the life of the forward contract extends from a date prior to March 31, 1978 to the anticipated transaction date or a later date.
- Amends paragraph 27(b) of FASB Statement No. 8 to permit the deferral of a gain or loss on a portion of a forward contract in excess of the amount of the foreign currency commitment to the extent that such portion is intended to provide a hedge on an after-tax basis. A gain or loss so deferred shall be included as an offset to the related tax effects in the period in which such tax effects are recognized.
- Effective prospectively beginning January 1, 1978. Earlier application encouraged for financial statements not previously issued. Restatement of previously issued financial statements is prohibited.

**No. 21 — *Suspension of the Reporting of Earnings Per Share and Segment Information by Nonpublic Enterprises*, an amendment of APB Opinion No. 15 and FASB Statement No. 14 (April 1978)**

- Suspends the requirements of APB Opinion No. 15 and FASB Statement No. 14 in the financial statements of nonpublic enterprises, pending completion of a major project on financial statements and financial reporting that focuses, in part, on small and closely held enterprises.
  - Defines a nonpublic enterprise as an enterprise other than one (a) whose debt or equity securities trade in a public market on a foreign or domestic stock exchange or in the over-the-counter market (including securities quoted only locally or regionally) or (b) that is required to file financial statements with the Securities and Exchange Commission.
    - The suspension applies to enterprises with a broad class of public participants (such as mutual associations, cooperatives, nonbusiness organizations, and partnerships) that otherwise meet the nonpublic definition.
    - An enterprise is no longer nonpublic when its financial statements are issued in preparation for the sale of securities in a public market.
  - The suspension applies to a complete set of separately issued financial statements of a subsidiary, corporate joint venture, or other investee that is nonpublic as the term is used in the Statement.
  - The Statement does not affect the disclosure of information about economic dependency, as discussed in Statement on Auditing Standards No. 6, when such disclosure may be necessary for a fair presentation.
- Effective April 30, 1978 retroactive to fiscal years beginning after December 15, 1976, the effective date of FASB Statement No. 14.
- Amended by FASB Statement No. 24, *Reporting Segment Information in Financial Statements That Are Presented in Another Enterprise's Financial Report*.

**No. 22 — *Changes in the Provisions of Lease Agreements Resulting From Refundings of Tax-Exempt Debt*, an amendment of FASB Statement No. 13 (June 1978) (Incorporated in codification FASB Statement No. 13, *Accounting for Leases*, May 1980.)**

- Reconciles an apparent inconsistency between Statement No. 13 and APB Opinion No. 26, *Early Extinguishment of Debt*, arising from refundings of tax-exempt debt, including advance refundings that are accounted for as early extinguishments of debt.
- Effective for lease agreement revisions entered into on or after July 1, 1978. The provisions of this Statement shall be applied retroactively at the same time and in the same manner as the provisions of Statement No. 13 are applied retroactively, except that enterprises that have already applied Statement No. 13 retroactively in published annual financial statements need not apply this Statement retroactively.

**No. 23 — *Inception of the Lease*, an amendment of FASB Statement No. 13 (August 1978) (Incorporated in the codification of FASB Statement No. 13, *Accounting for Leases*, May 1980.)**

- Reconsiders the application of Statement No. 13 for a leasing transaction in which the lessor and lessee agree on lease terms prior to the construction of the asset to be leased.

- Effective for leasing transactions recorded and lease agreement revisions recorded as of December 1, 1978 or thereafter. The provisions of the Statement shall be applied retroactively at the same time and in the same manner as the provisions of Statement No. 13, except that entities that have already applied Statement No. 13 retroactively in published annual financial statements need not apply this Statement retroactively.

**No. 24 — *Reporting Segment Information in Financial Statements That Are Presented in Another Enterprise's Financial Report*, an amendment of FASB Statement No. 14 (December 1978)**

- Eliminates the requirement to disclose segment information in a complete set of financial statements that is presented in another enterprise's financial report (i.e., the primary reporting enterprise):
  - If those financial statements are also consolidated or combined in a complete set of financial statements and both sets of financial statements are presented in the same financial report, or
  - If those financial statements are presented for certain foreign investees, or
  - If those financial statements are presented in the financial report of an enterprise that is not subject to the requirements of FASB Statement No. 14 because of the suspension provided by FASB Statement No. 21 relating to nonpublic enterprises.
- Effective January 1, 1979 retroactive to fiscal years beginning after December 15, 1976. Earlier application is encouraged.

**No. 25 — *Suspension of Certain Accounting Requirements for Oil and Gas Producing Companies*, an amendment of FASB Statement No. 19 (February 1979)**

- Suspends the effective date for application of those portions of FASB Statement No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies*, that pertain to a required form of successful efforts accounting.
  - Does not suspend those same portions of Statement No. 19 insofar as they provide definition of terms or provide direction and guidance for financial statement disclosures required by other portions of that Statement.
  - Statement No. 19 continues in effect as a Statement issued by the FASB for purposes of justifying a change in accounting method under APB Opinion No. 20, *Accounting Changes*.
    - Accounting changes to adopt the provisions of Statement No. 19 shall be made by retroactive restatement of prior periods as provided for in that Statement.
- Enterprises that presently use a full cost method and subsequently adopt accounting changes to conform to the full cost rules promulgated by the Securities and Exchange Commission (SEC) shall make those changes retroactively by restating prior-period financial statements.
- Disclosure requirements of Statement No. 19 are amended to permit the disclosure of reserve quantities to be made as supplementary information accompanying, but outside, the financial statements.
- Definitions of proved reserves, proved developed reserves and proved undeveloped reserves used in applying this Statement and Statement No. 19 shall be the definitions adopted by the SEC.
  - Definitions of reserves provided in Statement No. 19 are rescinded.

- Previously reported quantities of various reserves shall not be revised retroactively if the SEC definitions are changed.
- An enterprise engaged in oil and gas producing activities shall disclose the method of accounting for the costs incurred in those activities and the manner of disposing of capitalized costs related to those activities.
- For all other purposes, the effective date of Statement No. 19 is amended to fiscal years ending after December 25, 1979, although prior application is encouraged.
  - The suspension, as a mandatory requirement, of the form of successful efforts accounting prescribed by Statement No. 19 is an indefinite suspension.
- Effective for fiscal years beginning after December 15, 1978.

**No. 26 — *Profit Recognition on Sales-Type Leases of Real Estate*, an amendment of FASB Statement No. 13 (April 1979) (Incorporated in the codification of FASB Statement No. 13, *Accounting for Leases*, May 1980.)**

- Amends paragraph 8 of Statement No. 13 to require that a lease involving real estate that would otherwise be classified as of the inception date as a sales-type lease giving rise to a manufacturer's or dealer's profit shall be classified as an operating lease unless at the beginning of the lease term it also meets the requirements that a sale of the same property would have to meet for full and immediate profit recognition under the AICPA Industry Accounting Guide, *Accounting for Profit Recognition on Sales of Real Estate*.
- Effective for leasing transactions, and lease agreement revisions, recorded as of August 1, 1979 or thereafter. The provisions shall be applied retroactively at the same time and in the same manner as the provisions of FASB Statement No. 13 are applied retroactively, except that enterprises that have already applied Statement No. 13 retroactively in published annual financial statements need not apply this Statement retroactively.

**No. 27 — *Classification of Renewals or Extensions of Existing Sales-Type or Direct Financing Leases*, an amendment of FASB Statement No. 13 (May 1979) (Incorporated in the codification of FASB Statement No. 13, *Accounting For Leases*, May 1980.)**

- Modifies Statement No. 13 to require the classification of a renewal or extension of an existing sales-type or direct financing lease as a sales-type lease if it would otherwise so qualify, and the renewal or extension occurs at or near the end of the original lease term.
- Effective for lease agreement renewals and extensions recorded as of September 1, 1979 or thereafter. The provisions shall be applied retroactively at the same time and in the same manner as the provisions of Statement No. 13 are applied retroactively, except that enterprises that have already applied Statement No. 13 retroactively in published annual financial statements need not apply this Statement retroactively.

**No. 28 — *Accounting for Sales With Leasebacks*, an amendment of FASB Statement No. 13 (May 1979) (Incorporated in the codification of FASB Statement No. 13, *Accounting for Leases*, May 1980.)**

- Modifies paragraph 33 of Statement No. 13 to allow for recognition of profit on a sale and leaseback under certain circumstances.

- Modifies paragraph 33 of Statement No. 13 to require that, for an operating lease where profit or loss is deferred, it be amortized over the lease term, not the period of expected use.
- Effective for leasing transactions and lease agreement revisions recorded as of September 1, 1979. Provisions of this Statement shall be applied retroactively at the same time and in the same manner as the provisions of Statement No. 13 are applied retroactively, except that enterprises that have already applied Statement No. 13 retroactively in published annual financial statements need not apply this Statement retroactively.

**No. 29 — *Determining Contingent Rentals*, an amendment of FASB Statement No. 13 (June 1979) (Incorporated in codification of FASB Statement No. 13, *Accounting For Leases*, May 1980.)**

- Modifies Statement No. 13 to exclude contingent rentals, as defined, from minimum lease payments.
- Effective for leasing transactions and lease agreement revisions recorded on or after October 1, 1979. The provisions shall be applied retroactively at the same time and in the same manner as the provisions of Statement No. 13 are applied retroactively, except that enterprises that have already applied Statement No. 13 retroactively in published annual financial statements need not apply this Statement retroactively.

**No. 30 — *Disclosure of Information About Major Customers*, an amendment of FASB Statement No. 14 (August 1979)**

- Amends the requirements of paragraph 39 of FASB Statement No. 14, *Financial Reporting for Segments of a Business Enterprise*, regarding disclosure of revenue derived from a single customer accounting for 10% or more of total sales.
  - For purposes of disclosure, the federal government, a state government, a local government (for example, a county or municipality) or a foreign government shall each be considered as a single customer.
  - The identity of the customer need not be disclosed, but the identity of the industry segment or segments making the sales shall be disclosed.
- Effective for fiscal years beginning after December 15, 1979. The Statement need not be applied retroactively to previously issued financial statements.

**No. 31 — *Accounting for Tax Benefits Related to U.K. Tax Legislation Concerning Stock Relief* (September 1979)**

- Specifies how an enterprise reporting in accordance with U.S. GAAP should account for the tax effects related to the provisions of the 1979 United Kingdom (U.K.) tax legislation concerning recapture of "stock (inventory) relief" deductions.
- Background:
  - For purposes of determining U.K. taxable income, enterprises are permitted to deduct increases in the carrying amount of inventories. This deduction is included in U.K. taxable income (recaptured) if inventories decrease in future years.
  - Tax benefits relating to this deduction have been deferred as if this deduction were a timing difference that reverses if inventories decrease in future years.



- Effective on July 26, 1979, the U.K. adopted legislation that limits the timing and the amount of tax that could be recaptured.
- The tax benefit related to the current deductions for “stock relief” should be deferred unless it is probable that the tax benefit will not be recaptured prior to the end of the relevant six-year recapture period.
- Previously provided deferred tax benefits related to “stock relief” deductions should be recognized in the earliest of the period in which the recapture period expires or the period in which circumstances change and it becomes probable that the tax benefits will not be recaptured.
- If the tax benefit related to “stock relief” has not been deferred and circumstances subsequently change, the tax benefit attributable to the “stock relief” shall be deferred to the extent appropriate by a charge to income tax expense of the period in which circumstances change.
- For interim reporting purposes, *except for purposes of initial application*, any change in circumstances requiring an adjustment of the tax benefit related to “stock relief” should be treated as an adjustment of the estimated annual effective tax rate.
- If a significant variation in the customary relationship between income tax expense and pretax accounting income is created by accounting for “stock relief” in accordance with the statement, that fact shall be disclosed.
- Effective for annual and interim financial statements issued after September 30, 1979 for periods ending on or after July 26, 1979. For initial application of the Statement in interim periods ending after July 26, 1979, any recognition of previously deferred tax benefits related to “stock relief” should be reported as an item of tax expense for that interim period.

**No. 32 – *Specialized Accounting and Reporting Principles and Practices in AICPA Statements of Position and Guides on Accounting and Auditing Matters*, an amendment of APB Opinion No. 20 (September 1979)**

- Adopts the specialized accounting and reporting principles and practices contained in the AICPA Industry Accounting Guides, Industry Audit Guides, and Statements of Position, listed in Appendix A of the Statement as preferable accounting principles for purposes of applying APB Opinion No. 20, *Accounting Changes*.
  - Defers action on the Industry Audit Guide, *Audits of State and Local Governmental Units*, and two related SOPs pending completion of discussions on the role of the FASB in accounting for governmental units.
  - Special procedures are established for adopting SOPs and Guide revisions in process.
- Does not require any enterprise to change the accounting principles it *currently uses* to those specified in the Guides and SOPs.
  - Does not take any position with respect to the initial adoption of an accounting principle prior to completion of appropriate due process on the specialized principles and practices.
- Effective October 31, 1979. Earlier application is encouraged.
- At its October 31, 1979 meeting, the Board approved the use of task forces to extract the specialized accounting and reporting principles and practices for preparation of Exposure Drafts of proposed Standards on these AICPA Statements of Position and Guides.

**No. 33 – Financial Reporting and Changing Prices (September 1979)**

- Establishes standards for reporting the effects on business enterprises of changes in general prices (general inflation) and changes in the prices of certain specific types of assets (current costs).
  - Requires that the effects of changing prices be presented as supplementary information to the primary financial statements.
    - The effects of general inflation are measured by the use of *constant dollar accounting*, a method of reporting financial statement elements in dollars each of which has the same general purchasing power.
    - The effects of changes in the prices of specific types of assets are determined through the use of *current cost accounting*, a method of reporting assets, and expenses associated with the use or sale of assets, at their current cost or lower recoverable amount at the balance sheet date or at the date of use or sale.
  - No changes are made in the primary financial statements.
- Applicable to U.S. public enterprises, as defined in the Statement, that prepare their primary financial statements in U.S. dollars and in accordance with U.S. generally accepted accounting principles and that, at the beginning of the fiscal year for which financial statements are being presented (on a consolidated basis, if applicable), meet either of the following two conditions:
  - Inventories and property, plant, and equipment (before deducting accumulated depreciation, depletion, and amortization) amount in the aggregate to more than \$125 million;
    - Inventory and property, plant, and equipment includes land, other material resources and capitalized leases, but not goodwill or other intangible assets.
  - Total assets amount to more than \$1 billion (after deducting accumulated depreciation).
- The information need not be presented:
  - In interim financial reports,
  - For segments of a business, or
  - For a parent company, an investee company, or other enterprise in any financial report that includes the results for that enterprise in consolidated financial statements.
- Special problems in the forest products, mining, oil and gas, and real estate industries require further study to provide a basis for implementing the requirements of current cost disclosure.
  - Pending completion of these studies, enterprises are not required to disclose information about the current costs of unprocessed natural resources and income-producing real estate properties.
- Required disclosures for the current year include the following information:
  - Income from continuing operations on an historical cost/constant dollar basis and on a current cost basis.
    - Income from continuing operations excludes the results of discontinued operations, extraordinary items, and the cumulative effect of accounting changes.
  - Purchasing power gain or loss on net monetary items.

- Current cost amounts of inventory and property, plant and equipment.
- Increases or decreases in the current cost amounts of inventory and property, plant and equipment held during the period net of inflation (holding gains or losses net of inflation).
- Additional information required includes disclosure of:
  - The types of information used to calculate the current cost of inventory, property, plant and equipment, cost of goods sold, and depreciation, depletion, and amortization expense.
  - Any differences from the primary statement in depreciation methods, estimates of useful lives, and salvage values used for purposes of the supplementary disclosure.
  - The fact that no adjustments were made to income tax expense as reported in the primary financial statements.
- Required disclosures for each of the five most-recent fiscal years. These disclosures include:
  - Historical cost/constant dollar information:
    - Net sales and other operating revenues.
    - Income from continuing operations.
    - Income per share from continuing operations.
    - Net assets at fiscal year end.
    - Cash dividends declared per common share.
  - Current cost information:
    - Income from continuing operations.
    - Income per common share from continuing operations.
    - Net assets at fiscal year end.
    - Increases or decreases in the current cost amounts of inventory and property, plant and equipment, net of inflation.
    - Purchasing power gain or loss on net monetary items.
  - Other:
    - Market price per common share at fiscal year end.
    - The average level (or end-of-year-level, if used for the measurement of income from continuing operations) of the Consumer Price Index for All Urban Consumers (CPI-U) for each year included in the summary.
- The index used to compute information on a constant dollar basis is the CPI-U.
  - An enterprise that presents the minimum historical cost/constant dollar information required must use, for restatement purposes, the average level over the fiscal year of the CPI-U.
    - Minimum restatement covers inventory, property, plant and equipment, cost of goods sold, depreciation, depletion, and amortization expense, and any reductions of the historical cost amounts of inventory and property, plant, and equipment to lower recoverable amounts.
    - Other financial statement elements need not be restated.

- An enterprise that presents *comprehensive* financial statements on an historical cost/constant dollar basis may measure the components in either average-for-the-year constant dollars or in end-of-year constant dollars.
- Items measured in units of a foreign currency shall first be translated into U.S. dollars in accordance with generally accepted accounting principles and then be restated in constant dollars.
- Guidance is provided on the classification of balance sheet items as monetary or non-monetary.
- Details are provided for such matters as current cost measurements and sources of information about current costs.
- If the recoverable amount for a group of assets is judged to be materially and permanently lower than historical cost in constant dollars or current dollars, the recoverable amount must be used as the measure of the asset and related expense.
  - Recoverable amounts may be measured by considering net realizable value or the values in use of the assets.
  - Special rules apply to companies subject to rate regulation or other forms of price control.
- Effective for fiscal years ended on or after December 25, 1979.
  - Information on a current cost basis for fiscal years ended before December 25, 1980 may be presented in the first annual report for a fiscal year that ends on or after December 25, 1980.
  - Of the above information, only the following information need be stated in the five-year summary for fiscal years ended before December 25, 1979:
    - Net sales and other operating revenues.
    - Cash dividend declared per common share.
    - Market price per common share at fiscal year end.
  - Disclosures of current cost information in the five-year summary for fiscal years ending before December 25, 1980 may be postponed to the first annual report for a fiscal year ending on or after December 25, 1980.
  - An enterprise that first applies the requirements for a fiscal year ended on or after December 25, 1980 is required to state in the five-year summary for earlier years the following, in constant dollars:
    - Net sales and other operating revenues.
    - Cash dividend declared per common share.
    - Market price per common share at fiscal year end.
- Supplemented by:
  - FASB Statement No. 39, *Financial Reporting and Changing Prices: Specialized Assets — Mining and Oil and Gas*.
  - FASB Statement No. 40, *Financial Reporting and Changing Prices: Specialized Assets — Timberlands and Growing Timber*.
  - FASB Statement No. 41, *Financial Reporting and Changing Prices: Specialized Assets — Income-Producing Real Estate*.

- *Illustrations of Financial Reporting and Changing Prices* (December, 1979)
  - Issued as a supplement to FASB Statement No. 33, it contains illustrations that might be appropriate in annual reports of companies in particular industries.
- *Examples of the Use of FASB Statement No. 33, Financial Reporting and Changing Prices* (November 1980)
  - Contains illustrations, drawn from 1979 annual reports of various companies, of the disclosures required by Statement No. 33.

**No. 34 – Capitalization of Interest Cost (October 1979)**

- Establishes standards of financial accounting and reporting for capitalizing interest cost as a part of the historical cost of acquiring certain assets.
  - Interest cost includes interest recognized on obligations having explicit interest rates, interest imputed on payables in accordance with APB Opinion No. 21, *Interest on Receivables and Payables*, and interest relating to a capital lease.
  - Interest that might be imputed on owners' equity is excluded.
- Interest cost shall be capitalized as part of the historical cost of acquiring an asset if a significant period of time elapses between the initial expenditure related to development of the asset and its readiness for its intended use, and if such a period of time is required to bring the asset to the condition and location necessary for its intended use.
- Assets qualifying for interest capitalization include:
  - Assets that are constructed or otherwise produced for an enterprise's own use.
  - Assets intended for sale or lease that are constructed or otherwise produced as discrete projects, such as ships or real estate developments.
- Interest should *not* be capitalized for the following:
  - Inventories that are routinely manufactured or otherwise produced in large quantities on a repetitive basis.
  - Assets that are in use or ready for their intended use.
  - Assets that are not being used in the earning activities of the enterprise.
- The amount of interest cost allocated in an accounting period shall be determined by applying an interest rate to the average amount of accumulated expenditures for the qualified asset during the period, and shall not exceed the amount of total interest cost incurred by the enterprise during that period.
  - If an enterprise's financial plans associate a specific new borrowing with a qualifying asset, the enterprise may use the rate on that borrowing as the capitalization rate.
  - If the average accumulated expenditures for the asset exceed the amounts of specific new borrowings associated with the asset, the capitalization rate to be allocated to the excess shall be the weighted average of the rates applicable to other borrowings.
  - The relevant enterprise for interest capitalization is the enterprise for which financial statements are presented. A consolidated group of companies may be viewed as a single entity for financing purposes.
- Capitalization begins when the first development expenditure is made, and continues as long as the asset is undergoing active development that is necessary to get the asset ready for its intended use, and interest is being incurred. Interest capitalization shall end when the asset is substantially complete and ready for its intended use.

- The following disclosures are required:
  - For an accounting period in which no interest cost is capitalized, the amount of interest cost incurred and charged to expense during the period.
  - For an accounting period in which some interest cost is capitalized, the total amount of interest cost incurred during the period and the amount thereof that has been capitalized.
- Shall be applied prospectively in fiscal years beginning after December 15, 1979. Earlier application is permitted, but not required in financial statements for fiscal years beginning before December 19, 1979 that have not been previously issued. If early application is adopted, financial reports for any interim periods of that fiscal year that precede the period of adoption shall be restated.
- Interpreted by FASB Interpretation No. 33, *Applying FASB Statement No. 34 to Oil and Gas Producing Operations Accounted for by the Full Cost Method*.

**No. 35 – Accounting and Reporting by Defined Benefit Pension Plans (March 1980)**

- Establishes standards of financial accounting and reporting for annual financial statements of defined benefit pension plans, and applies to plans that are subject to the provisions of ERISA (covered plans) as well as to those that are not.
  - Covered plans may additionally provide benefits on death, disability, or termination of employment.
  - Does not apply to a plan that is expected to be terminated, nor to a government-sponsored social security plan.
- This Statement does not require the preparation, distribution, or attestation of any plan's financial statements.
- The primary objective of a plan's financial statements is to provide financial information that is useful in assessing a plan's present and future ability to pay benefits when due.
- The annual financial statements of a plan shall include the following:
  - A statement that includes information on the net assets available for benefits as of the end of the plan year.
  - A statement that includes information on changes during the year in net assets available for benefits.
  - Information on the actuarial present value of accumulated plan benefits:
    - The benefit valuation date may be either the beginning or the end of the plan year.
    - If the benefit valuation date is the beginning of the year, then a statement of net assets available at that date and of changes in net assets during the preceding year should be presented.
  - Information on the effects of factors affecting the year-to-year change in the actuarial present value of accumulated plan benefits.
  - Flexibility is allowed in presenting information regarding the actuarial present value of accumulated plan benefits, and year-to-year changes therein.
- Accounting principles set forth in the Statement include the following:
  - Accrual basis of accounting is required.

- Contributions receivable shall include all amounts legally or contractually due as well as amounts due pursuant to formal commitments.
- Plan investments, whether equity or debt securities, real estate, or other (excluding contracts with insurance companies) shall be presented at their fair value (i.e., current selling price) at the reporting date.
- Insurance contracts shall be recognized and measured in the same manner as required for reporting under ERISA.
- Operating assets shall be presented at cost less accumulated depreciation.
- Minimum disclosure requirements are set forth for changes in net assets available for benefits.
- Accumulated plan benefits are those future benefit payments that are attributable under the plan's provisions to employees' service rendered to the benefit information date.
  - Accumulated plan benefits comprise benefits expected to be paid to:
    - Retired or terminated employees or their beneficiaries.
    - Beneficiaries of deceased employees.
    - Present employees or their beneficiaries.
  - Specific rules are provided for measuring accumulated plan benefits.
  - Changes in actuarial assumptions made to reflect changes in the plan's expected experience shall be viewed as changes in estimate.
  - Minimum disclosure shall include the significant effects of factors affecting a change in the actuarial present value of accumulated plan benefits, such as:
    - Plan amendments.
    - Changes in the nature of the plan (such as a plan spinoff or a merger with another plan).
    - Changes in actuarial assumptions.
  - Total actuarial present value of accumulated plan benefits as of the benefit information date shall be segmented into at least the following categories:
    - Vested benefits of participants currently receiving payments
    - Other vested benefits
    - Nonvested benefits
- The use of averages or other methods of approximation is appropriate provided the results are substantially the same as would be obtained under detailed rules.
- Disclosures specifically related to plans are set forth in detail.
- Effective for plan years beginning after December 15, 1980.
  - Accounting changes to conform to this Statement shall be made retroactively.
  - Prior years' statements when presented for comparative purposes shall be restated.
  - If accounting changes were necessary to conform to the provisions of this Statement, that fact shall be disclosed.

**No. 36 — *Disclosure of Pension Information*, an amendment of APB Opinion No. 8 (May 1980)**

- The Board decided that the lack of comparable disclosures in employers' financial statements about the financial status of their pension plans requires amendment of existing disclosure standards as an interim measure pending completion of the project on accounting by employers for pensions.
  - This Statement does not alter the definitions of a defined benefit pension plan and a defined contribution plan contained in Appendix B of APB Opinion No. 8, *Accounting for the Cost of Pension Plans*.
- The following disclosures are required:
  - A statement that pension plans exist, and identification of the employee groups covered,
  - A statement of the company's accounting and funding policies,
  - The provision for pension costs for the period,
  - Nature and effect of significant matters affecting comparability of pension information for all periods presented, such as change in accounting methods, or changes in circumstances.
- For defined benefit pension plans the following required disclosures shall be determined in accordance with Statement No. 35, *Accounting and Reporting by Defined Benefit Pension Plans*, as of the most recent benefit information date for which the data are available:
  - The actuarial present value of vested accumulated plan benefits,
  - The actuarial present value of nonvested accumulated plan benefits.
  - The plans' net assets available for benefits,
  - The assumed rates of return used in determining the actuarial present values of vested and nonvested accumulated plan benefits,
  - The date as of which the benefit information was determined.
    - The data may be reported in total for all plans, separately for each plan, or in sub-aggregated form.
  - For plans for which the above data are not available, the employer shall continue to comply with the disclosure requirements originally contained in APB Opinion No. 8.
    - The reasons why the required information is not provided shall be disclosed.
- Effective for annual financial statements for fiscal years beginning after December 15, 1979, and for complete sets of interim financial statements issued after June 30, 1980.
  - The disclosures required by this Statement need not be included in financial statements for periods beginning before the effective date of this Statement that are being presented for comparative purposes with financial statements for periods after the effective date.

**No. 37 — *Balance Sheet Classification of Deferred Income Taxes*, an amendment of APB Opinion No. 11 (July 1980)**

- Clarifies the classification of deferred income tax charges and credits where no asset or liability that is related to the timing difference exists.



- Also clarifies the balance sheet classification of the tax benefits related to "stock relief" under FASB Statement No. 31, *Accounting for Tax Benefits Related to U.K. Tax Legislation Concerning Stock Relief*.
- A deferred charge or credit that is related to an asset or liability shall be classified as current or noncurrent based on the classification of the related asset or liability.
  - A deferred charge or credit is related to an asset or liability of reduction of the asset or liability causes the timing difference to reverse.
    - The term "reduction" includes amortization, sale or other realization of an asset, and amortization, payment or other satisfaction of a liability.
- A deferred charge or credit that is not related to an asset or liability shall be classified based on the expected reversal date of the specific timing difference.
  - A deferred charge or credit is not related to an asset or liability if:
    - There is no associated asset or liability.
      - For example, a change in accounting method for tax purposes from the cash to the reserve method of accounting for bad debts where the effect is to be amortized for tax purposes over ten years would give rise to a deferred tax item unrelated to trade receivables or the provision for doubtful accounts. The collection or write-off of the receivables will not cause the timing difference to reverse. The timing difference will reverse over time (ten years, in this example).
    - A reduction of an associated asset or liability will not cause the timing difference to reverse.
    - Tax benefits related to "stock relief" that have been deferred under FASB Statement No. 31, are not timing differences, and should be classified based on the period of potential recapture.
- Effective for financial statements for periods ending after December 15, 1980.
  - Reclassification in previously issued financial statements is permitted but not required.

**No. 38 — *Accounting for Preacquisition Contingencies of Purchased Enterprises*, an amendment of APB Opinion No. 16 (September 1980)**

- Specifies the application of FASB Statement Nos. 5, *Accounting for Contingencies*, and 16, *Prior Period Adjustments*, and APB Opinion No. 16, *Business Combinations*, to pre-acquisition contingencies of purchased enterprises and adjustments that result from resolution of those contingencies.
  - Applies to situations such as the following:
    - An acquired enterprise has litigation pending at the acquisition date.
    - An unexpected lawsuit arises that relates to events that occurred before the acquisition but is filed after that date.
  - Does not apply to potential income tax benefits of preacquisition net operating loss carryforwards or adjustments that result from realization of those benefits.
- A preacquisition contingency is a contingency acquired in a business combination accounted for by the purchase method and that is in existence before the consummation of the combination.

- A preacquisition contingency may include:
  - A contingent asset.
  - A contingent liability.
  - A contingent impairment of an asset.
- A preacquisition contingency, other than the potential tax benefit of a loss carryforward, shall be included in the purchase allocation based on an amount determined as follows:
  - If the fair value can be determined during the “allocation period”, the contingency shall be included in the allocation of the purchase price based on that fair value.
    - “Allocation period” is the period required to identify and quantify the assets acquired and the liabilities assumed.
    - The allocation period ends when the acquiring enterprise is no longer waiting for information that it has arranged to obtain and that is known to be available or obtainable.
    - The allocation period should usually not exceed one year from the consummation of a business combination.
  - If the fair value cannot be determined during the allocation period, the preacquisition contingency shall be included in the allocation of the purchase price based on an amount determined under the following criteria:
    - Information prior to the end of the allocation period indicates that it is probable that an asset existed, a liability had been incurred, or an asset had been impaired at the consummation of the business combination.
    - The amount of the asset or liability can be reasonably estimated.
    - Guidance is provided by FASB Statement No. 5, and related FASB Statement No. 14, *Reasonable Estimation of the Amount of a Loss*.
- After the end of the allocation period, an adjustment that results from a preacquisition contingency other than a loss carryforward shall be included in the determination of net income in the period in which the adjustment is determined.
- Effective for preacquisition contingencies assumed in business combinations initiated after December 15, 1980.
  - Application to preacquisition contingencies assumed in business combinations initiated prior to December 16, 1980 is encouraged but not required.
    - Special provisions apply to early applications.
  - If the provisions of this Statement are not applied to all unresolved preacquisition contingencies as permitted, then special disclosures are required for resolutions after December 15, 1980 that result from preacquisition contingencies not accounted for as recommended by this Statement.

**No. 39 — Financial Reporting and Changing Prices: Specialized Assets — Mining and Oil and Gas, a supplement to FASB Statement No. 33 (October 1980)**

- Supplements FASB Statement No. 33, *Financial Reporting and Changing Prices*, by requiring measurement of mineral resource assets and related expenses at current cost or lower recoverable amount.

- Mineral resource assets are assets that are directly associated with and derive value from all minerals extracted from the earth and include:
  - Mineral interests in properties.
  - Completed and uncompleted wells.
  - Related equipment and facilities and other facilities required for purposes of extraction.
  - Excludes support equipment which is included in property, plant and equipment subject to FASB Statement No. 33.
- Defines proved and probable mineral reserves in extractive industries other than oil and gas.
- The requirements of this Statement apply to enterprises identified in Statement No. 33, and apply in the manner specified in Statement No. 33.
  - Disclosure is required of the principal types of information used to measure current cost of mineral resource assets.
- An enterprise shall measure the current cost or lower recoverable amount of mineral resource assets and related depreciation, depletion and amortization expense in computation of the following:
  - Income from continuing operations on a current cost basis.
  - The current cost amounts of inventory and property, plant and equipment.
  - Increases or decreases in the current cost amounts of inventory and property, plant and equipment net of inflation.
  - Current cost information in the five year summary.
- The current cost of mineral resource assets may be determined by:
  - Current market buying prices.
  - Current cost funding.
    - No generally accepted approach exists for this measurement.
    - One approach is simply to adjust historical cost by an index of the changes in specific prices of the inputs concerned.
    - The requirements are flexible as to approach, which may include:
      - Specific price indices.
      - Direct information or market buying prices.
      - Other statistical evidence of the cost of acquisitions.
- Quantity and price information is required for minerals other than oil and gas for the following:
  - Proved or proved and probable mineral reserves at the end of the year or the most recent date.
  - Minerals that are recoverable.
  - Minerals, by kinds, produced during the year.
  - Mineral reserves purchased or sold in place.
- For each significant mineral product, the average market price or internal transfers, or the equivalent market price prior to use in manufacturing must be given.

- Special rules apply to consolidated financial statements and investments accounted for by the equity method.
- The Board has decided not to require the disclosure of any new information, apart from information on a current cost basis, from the oil and gas industry until further study of all the present requirements.
- Effective for fiscal years ended on or after December 25, 1980.
  - Disclosure for fiscal years ended before December 25, 1980 is encouraged but not required.
  - An enterprise first required to apply this Statement for fiscal years ended on or after December 25, 1981 is not required to disclose the information for earlier years.

**No. 40 — *Financial Reporting and Changing Prices: Specialized Assets — Timberlands and Growing Timber*, a supplement to FASB Statement No. 33 (November 1980)**

- Extends the interim provisions of FASB Statement No. 33, *Financial Reporting and Changing Prices*, for the measurement of timberlands and growing timber, requiring enterprises that present information on a current cost basis to combine measures of timberlands, growing timber, and related expenses at either historical cost/constant dollar amounts or at current cost amounts with current cost measures of other assets and expenses.
  - Provides greater flexibility in measurement because current cost is a broader measure than historical cost adjusted by a specific price index.
  - An enterprise needs to present information on a current cost basis only if it has significant holdings of inventory, property, plant, and equipment apart from timberlands and growing timber.
  - The applicability of the interim provisions shall continue indefinitely until amended.
- Presentation of information on timberlands, growing timber, and timber held under cutting contracts and related expenses for years ending on or after December 25, 1980 may be made at either their historical cost/constant dollar amounts or at current cost or lower recoverable amounts.
  - Estimates of current cost arrived at by adjusting historical cost for the changes in specific prices may be computed on either of the following bases:
    - Costs as capitalized in the primary financial statements.
    - All costs that are directly related to reforestation and forest management, such as planting, fertilization, fire protection, and property taxes, whether or not those costs are capitalized in the primary financial statements.
- Effective for fiscal years ended on or after December 25, 1980.

**No. 41 — *Financial Reporting and Changing Prices: Specialized Assets — Income Producing Real Estate*, a supplement to FASB Statement No. 33 (November 1980)**

- Extends the interim provisions of FASB Statement No. 33, *Financial Reporting and Changing Prices*, for the measurement of income-producing real estate; requires enterprises that present information on a current cost basis to combine measures of income producing real estate and related expenses at either historical cost/constant dollar amounts or at current cost amounts with current cost measures of other assets and expenses.

- An enterprise needs to present information on a current cost basis only if it has significant holdings of inventory, property, plant, and equipment apart from income-producing real estate and certain other specialized assets.
- No time limit is set on the applicability of the interim provisions.
- Income-producing real estate comprises properties that meet all of the following criteria:
  - Cash flows can be directly associated with long-term leasing agreements with unaffiliated parties.
  - The property is being operated.
  - Future cash flows are reasonably estimatable.
  - Ancillary services are not a significant part of the lease agreement.
- If an enterprise presents information on a current cost basis for a fiscal year ended on or after December 25, 1980, it shall measure income-producing real estate and related expenses at either their historical cost/constant dollar amounts or at current cost or lower recoverable amounts.
- Effective for fiscal years ended on or after December 25, 1980.

**No. 42 — *Determining Materiality for Capitalization of Interest Cost*, an amendment of FASB Statement No. 34 (November 1980)**

- Amends FASB Statement No. 34, *Capitalization of Interest Cost*, by deleting the portion of paragraph 8 of Statement No. 34 that states that capitalization is not required under circumstances where the benefit may be less than the cost because the effect of interest capitalization and its subsequent amortization or other disposition, compared with the effect of charging it to expense when incurred, would not be material.
  - The cost/benefit considerations for capitalization of interest cost are limited to those situations described in paragraph 10 of Statement No. 34.
- Permits the use of “threshold levels” of capitalization, provided:
  - The threshold level is consistent with the enterprise’s capitalization policy on assets.
  - Items to which the threshold level is applied are not material either as units or in the aggregate.
- Effective for fiscal years beginning after December 15, 1979.
  - The provisions of the Statement would be applied at the same time as the provisions of Statement No. 34 are first applied.
  - Enterprises that have already adopted the provisions of Statement No. 34 may, but are not required to, restate their financial statements for the year of initial adoption to reflect the provisions of this Statement.

**No. 43 — *Accounting for Compensated Absences* (November 1980)**

- Establishes standards of accounting for employee absences such as vacations, illness, and holidays, for which it is expected that employees will be paid (referred to as compensated absences).

- The Statement does not apply to the following:
  - Severance or termination pay.
  - Post retirement benefits.
  - Deferred compensation.
  - Stock or stock options issued to employees.
  - Group insurance or long-term disability pay.
  - State and local governmental units.
- Applies to regulated enterprises in accordance with the provisions of the Addendum to APB Opinion No. 2, *Accounting for the "Investment Credit"*.
- Requires that an employer shall accrue a liability for employees' compensation for future absences if all of the following conditions are met:
  - The employer's obligation is attributable to employees' services already rendered.
  - The obligation relates to rights that vest or accumulate.
    - Vested rights are those for which an employer has an obligation to make payment even if an employee terminates employment.
    - Accumulated rights are those earned but unused rights to compensated absences that may be carried forward to one or more periods subsequent to that in which it is earned.
  - Payment of the compensation is probable.
  - The amount can be reasonably estimated.
  - Disclosure is required if a liability otherwise required is not accrued solely because the amount cannot be reasonably estimated.
- An employer is not required to accrue a liability for nonvesting accumulating rights to receive sick pay benefits.
  - The Statement, however, does not prohibit such an accrual providing the criteria for accrual are met.
- Effective for fiscal years beginning after December 15, 1980.
  - Earlier application is encouraged.
  - The provisions of the Statement shall be applied retroactively.
  - In the year the Statement is first applied, disclosure shall be made of any restatement and its effect on income before extraordinary items, net income, and related per share amounts for each year restated.
  - If retroactive restatement of all years presented is not practicable, the cumulative effect of applying the Statement shall be included in determining net income of the earliest year restated.
  - If it is not practicable to restate any prior year, the cumulative effect shall be included in net income in the year in which the Statement is first applied.

**No. 44 — *Accounting For Intangible Assets of Motor Carriers*, an amendment of Chapter 5 of ARB 43 and an interpretation of APB Opinion Nos. 17 and 30 (December 1980)**

- Clarifies the accounting for certain intangible assets of motor carriers affected by the Motor Carrier Act of 1980 (The Act).
  - If not separately allocated in the past, the costs of intangible assets shall now be assigned to:
    - Operating rights
    - Other identifiable intangible assets
    - Goodwill
- For purposes of identifying and assigning costs to the three categories, the criteria to be applied are those in paragraph 88 of APB Opinion No. 16, *Business Combinations*, and paragraphs 24-26 of Opinion No. 17, *Intangible Assets*, based on the circumstances existing when the assets were acquired.
  - Costs assigned to identifiable intangibles shall not reflect costs of developing, maintaining, or restoring those intangibles after they were acquired.
  - If identification and assignment of costs of intangibles is impracticable, then the motor carrier shall presume that all of those costs relate to interstate operating rights.
- Unamortized costs of interstate operating rights shall be charged to income and, if material, reported as an extraordinary item in accordance with paragraph 11 of APB Opinion No. 30, *Reporting the Results of Operations*.
  - After this Statement is first applied, any remaining costs of intangibles that are subsequently charged to income for reasons attributable to the Act shall not be reported as an extraordinary item.
  - Tax benefits, if any, relating to the costs of interstate operating rights charged to income shall be reported in accordance with the provisions of APB Opinion No. 11, *Accounting for Income Taxes*, and paragraph 25 of APB Opinion No. 30.
  - The cost of intrastate operating rights shall be accounted for in accordance with the provisions of this Statement if a state deregulates motor carriers with effects similar to those of the Act.
- Effective on December 19, 1980 for financial statements for fiscal periods ending after December 15, 1980.
  - Earlier application is encouraged.
  - This Statement shall not be applied retroactively.

## INTERPRETATIONS ISSUED

### **No. 1 – *Accounting Changes Related to the Cost of Inventory, an interpretation of APB Opinion No. 20 (June 1974)***

- A change in composition of the elements of costs included in inventory is an accounting change and a company making such a change should conform with APB Opinion No. 20, including justifying the change as to preferability determined on the basis of whether the new principle constitutes an improvement in financial reporting and not on the basis of income tax effect alone.
- Effective July 1, 1974.

### **No. 2 – *Imputing Interest on Debt Arrangements Made Under the Federal Bankruptcy Act, an interpretation of ABP Opinion No. 21 (June 1974) (Superseded by FASB Statement No. 15, *Accounting by Debtors and Creditors for Troubled Debt Restructurings* – June 1977)***

### **No. 3 – *Accounting for the Cost of Pension Plans Subject to the Employee Retirement Income Security Act of 1974, an interpretation of APB Opinion No. 8 (December 1974)***

- No change in the minimum or maximum limits for the annual provision for pension costs set forth in APB Opinion No. 8 is required as a result of the Act, although the actual amount charged may be changed.
- Any significant estimated effect on the future amount of an enterprise's periodic provision for pension expense, periodic funding of pension costs, or unfunded vested benefits shall be disclosed in the notes.
- At present the Board does not believe the Act creates a legal obligation for unfunded pension costs that warrants accounting recognition of a liability pursuant to APB Opinion No. 8, unless a plan is terminated.
- Effective December 31, 1974.

### **No. 4 – *Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method, an interpretation of FASB Statement No. 2 (February 1975)***

- FASB Statement No. 2 specifies that research and development costs be expensed. Interpretation No. 4 clarifies the accounting treatment to be given when research and development is acquired through a purchase business combination.
  - The fair value of the research and development of the acquired enterprise must be determined and suitable allocation of the purchase price made.
    - Those costs allocated to research and development that are to be used by the acquiring company for research and development purposes (as defined in FASB Statement No. 2) must then be written off to income.
    - Those costs allocated to research and development which will not be used by the acquiring company for research and development purposes, or which have alternative future use, may remain capitalized and be amortized over a suitable period.
    - Costs incurred under a contract to resell are not subject to FASB Statement No. 2.
  - Adequate disclosure of research and development costs acquired through a purchase business combination must be given.



- Effective for combinations initiated after March 1, 1975. Application to combinations initiated prior to April 1, 1975 and consummated after March 1, 1975 is encouraged but not required. Retroactive application is not required.

**No. 5 – *Applicability of FASB Statement No. 2 to Development Stage Enterprises*, an interpretation of FASB Statement No. 2 (February 1975) (Superseded by FASB Statement No. 7, *Accounting and Reporting by Development Stage Enterprises* – June 1975)**

**No. 6 – *Applicability of FASB Statement No. 2 to Computer Software*, an interpretation of FASB Statement No. 2 (February 1975)**

- FASB Statement No. 2 specifies that costs of certain computer software programs and procedures are research and development costs. Interpretation No. 6 provides guidelines for determining which computer costs are research and development costs pursuant to FASB Statement No. 2 and, therefore, must be expensed as incurred.
  - Costs incurred to purchase or lease computer software developed by others are research and development costs if the software is to be used in research and development activities of the acquiring enterprise, and therefore, they must be expensed as incurred.
  - Costs incurred in *development* of software are research and development costs if the software is used for developing or significantly improving a product or process (including the software package) that is intended to be sold, leased or otherwise marketed, and therefore, they must be expensed as incurred.

**NOTE:** FASB Statement No. 2 *does not specify any accounting* for costs that are deemed not to be research and development. Accounting for all such costs must, therefore, be in accordance with other authoritative literature and GAAP. It follows that each of those costs *may or may not* be capitalized. For example, computer software costs that are deemed to be general and administrative costs would be expensed as incurred.

- Effective for fiscal years beginning on or after April 1, 1975 although earlier application is encouraged.

**No. 7 – *Applying FASB Statement No. 7 in Financial Statements of Established Operating Enterprises*, an interpretation of FASB Statement No. 7 (October 1975)**

- Explains the applicability of FASB Statement No. 7 to an established operating enterprise's financial statements that include the financial statements of a development stage subsidiary or other investee.
- FASB Statement No. 7 does not address and does not alter GAAP for the preparation of consolidated financial statements. Therefore, the Statement does not address the question of whether a change in principle adopted in the separate statements of a development stage subsidiary to conform to FASB Statement No. 7 must be reflected in the consolidated statements.
- Capitalization or deferral of costs shall be subject to the same assessment of recoverability according to FASB Statement No. 7. This does not require that the results of the assessment must necessarily be the same. The Statement does not affect any accepted practice in consolidation of financial statements where the results of an assessment of recoverability of a cost may be different (a) in the broader context of a consolidated enterprise and (b) in the context of a development stage subsidiary standing alone.

- Except in circumstances described above, the effect of a development stage subsidiary's change in accounting principle to conform its accounting to the requirements of FASB Statement No. 7 generally would be reflected in the consolidated statements.
- Consolidated statements for periods prior to the effective date of Statement No. 7 shall be restated by prior period adjustment for such matters.
- Effective for fiscal periods beginning on or after January 1, 1976, although earlier application is encouraged.

**No. 8 – *Classification of a Short-Term Obligation Repaid Prior to Being Replaced by a Long-Term Security*, an interpretation of FASB Statement No. 6 (January 1976)**

- FASB Statement No. 6 specifies that a short-term obligation is to be excluded from current liabilities only if the enterprise intends to refinance it on a long-term basis and, before the balance sheet is issued, either has refinanced it or has entered into a financing agreement that permits refinancing on a long-term basis.
- This Interpretation holds that, where a short-term obligation is repaid after the balance sheet date and subsequently a long-term obligation or equity securities are issued whose proceeds are used to replenish current assets before the balance sheet is issued, the short-term obligation shall not be excluded from current liabilities at the balance sheet date.
- Effective on February 29, 1976 and applies to balance sheets dated on or after that date and to related statements of changes in financial position.

**No. 9 – *Applying APB Opinions No. 16 and 17 When a Savings and Loan Association or a Similar Institution Is Acquired in a Business Combination Accounted for by the Purchase Method*, an interpretation of APB Opinions Nos. 16 and 17 (February 1976)**

- Acquisition of a savings and loan association in a business combination accounted for by the purchase method shall be accounted for under the *separate-valuation* [of individual (or types of) assets and liabilities] method following paragraphs 87 and 88 of APB Opinion No. 16.
- Use of the *net-spread* method ignores fair value of individual (or types of) assets and liabilities and is, therefore, inappropriate under APB Opinion No. 16. (In the net-spread method, the acquisition of a savings and loan association is viewed as the acquisition of a leveraged whole rather than the acquisition of the separate assets and liabilities and, therefore, its mortgage loan portfolio and savings accounts are brought forward at the net carrying amount shown in the financial statements of the acquired association.)
- The purchase price may include an amount for special savings and loan factors (such as capacity to generate future income, new business, or nature of territory). The amount paid for separately identified intangible assets shall be recorded as the cost of the intangible and be amortized over its estimated life as specified in APB Opinion No. 17.
- Permits amortization of goodwill on other than straight-line method if goodwill includes certain intangible factors and if the benefits to be received from the factors decline over the expected life.
- Effective for business combinations initiated on or after March 1, 1976. Application for combinations initiated before March 1, 1976 but consummated on or after that date is encouraged but not required.

**No. 10 – *Application of FASB Statement No. 12 to Personal Financial Statements*, an interpretation of FASB Statement No. 12 (September 1976)**

- Specifies that FASB Statement No. 12 applies to personal financial statements of individuals prepared in conformity with generally accepted accounting principles.
- Effective for annual and interim periods ending after October 15, 1976. Early application is encouraged, but retroactive application to previously issued financial statements is not permitted.

**No. 11 – *Changes in Market Value After the Balance Sheet Date*, an interpretation of FASB Statement No. 12 (September 1976)**

- When assessing whether a decline in market value below cost is other than temporary, information about a gain or loss realized on subsequent disposition and unrealized gains and losses occurring after the balance sheet date are to be taken into consideration along with other factors. If the decline is other than temporary, the security must be written down to a new cost basis and the loss accounted for as realized. The loss is not to exceed the difference between the market value at the balance sheet date and the asset's cost.
- Effective for annual and interim periods ending after October 15, 1976. Early application is encouraged, but retroactive application to previously issued financial statements is not permitted.

**No. 12 – *Accounting for Previously Established Allowance Accounts*, an interpretation of FASB Statement No. 12 (September 1976)**

- Requires the elimination of temporary allowance accounts for marketable equity securities that were established prior to the effective date of FASB Statement No. 12 and the establishment of a valuation allowance account in accordance with the provisions of FASB Statement No. 12. Any balance remaining in an existing allowance account shall be eliminated by a credit to income in the period in which the Interpretation is initially applied.
- Effective for annual and interim periods ending after October 15, 1976. Early application is encouraged, but retroactive application to previously issued financial statements is not permitted.

**No. 13 – *Consolidation of a Parent and Its Subsidiaries Having Different Balance Sheet Dates*, an interpretation of FASB Statement No. 12 (September 1976)**

- Specifies the procedures to be followed and the disclosures required for marketable securities reported in consolidated financial statements that include a parent company and subsidiaries whose fiscal years are different from that of the parent. For example, to compute the amount of any valuation allowance(s) required by FASB Statement No. 12, the aggregate cost and aggregate market value of the portfolio(s) shall be determined for each subsidiary that is consolidated as of the date of each subsidiary's balance sheet.
  - Those aggregates shall then be combined with like figures of the parent determined as of the parent's balance sheet date. This principle carries through to other aspects of FASB Statement No. 12.
- Effective for annual and interim periods ending after October 15, 1976. Early application is encouraged, but retroactive application to previously issued financial statements is not permitted.

**No. 14 — *Reasonable Estimation of the Amount of a Loss*, an interpretation of FASB Statement No. 5 (September 1976)**

- Stipulates that, when the first condition of paragraph 8 of FASB Statement No. 5 is met with respect to a particular loss contingency and the estimated amount of loss is a range of amounts, the second condition is also met and a loss shall be accrued. If some amount in the range is a better estimate, that amount should be accrued. If no amount is a better estimate of the loss than any other amount, the minimum amount in the range should be accrued. Disclosure is required of the nature of the contingency and the exposure to an additional amount of loss of up to the maximum of the range.
- Effective for annual and interim periods beginning after October 15, 1976. Earlier application is encouraged. An accrual of a loss contingency or an adjustment of an established accrual for a loss contingency resulting from this Interpretation shall be accounted for as a change in estimate in accordance with the requirements of paragraph 31 of APB Opinion No. 20. The Interpretation is not to be applied retroactively to previously issued financial statements.

**No. 15 — *Translation of Unamortized Policy Acquisition Costs by a Stock Life Insurance Company*, an interpretation of FASB Statement No. 8 (September 1976)**

- Specifies that unamortized policy acquisition costs of a stock life insurance company are to be translated at historical rates.
- Computation of a reserve deficiency shall be made in dollars after translation of the unamortized policy acquisition costs at historical rates and the liability for future policy benefits at the current rate. The computation may require adjustment of a reserve deficiency computed by the foreign subsidiary.
- Effective for all unamortized policy acquisition costs reported in financial statements for annual and interim periods ending after December 15, 1976, except that it shall not be applied prior to initial application of FASB Statement No. 8. If applied concurrently with the initial application of FASB Statement No. 8, it shall be applied in the same manner as FASB Statement No. 8. If FASB Statement No. 8 has been applied prior to adoption of the Interpretation, application of the Interpretation may conform to the manner in which FASB Statement No. 8 was initially applied, or as APB Opinion No. 20 would require.

**No. 16 — *Clarification of Definitions and Accounting for Marketable Equity Securities That Become Nonmarketable*, an interpretation of FASB Statement No. 12 (February 1977)**

- Clarifies the definition of the terms "marketable" and "restricted stock" and clarifies the requirement of a new cost basis when a marketable security becomes nonmarketable.
- A temporary lack of trades or price quotations for an equity security at the balance sheet date does not make it nonmarketable if the required market prices are available on days closely preceding and following the balance sheet date. The market price of a security shall be determined from sales, bid and ask prices, or quotations, as appropriate, on the first day following the balance sheet date that the information is available.
- A security that is restricted by a governmental or contractual requirement but can reasonably be expected to qualify for sale within one year of the balance sheet date, and for which market price quotations for unrestricted securities of the same class are available as of the balance sheet date, is considered marketable at the balance sheet date.

- When a marketable equity security becomes nonmarketable or a nonmarketable equity security becomes marketable, that security shall be transferred to the appropriate portfolio at cost. The term cost is defined as original cost unless a new cost basis has been assigned based on recognition of impairment of value that was deemed other than temporary or as a result of a transfer from current to noncurrent classification.
- Effective for annual and interim periods ending after March 15, 1977. Earlier application is encouraged, but retroactive application to previously issued financial statements is not permitted.

**No. 17 – *Applying the Lower of Cost or Market Rule in Translated Financial Statements*, an interpretation of FASB Statement No. 8 (February 1977)**

- Clarifies the determination of market when applying the rule of cost or market, whichever is lower, in translated financial statements.
- In translated financial statements, translated market shall be current foreign currency replacement cost translated at the current rate, except that:
  - Translated market shall not exceed foreign currency net realizable value translated at the current rate; and
  - Translated market shall not be less than foreign currency net realizable value reduced by an allowance for an approximately normal profit margin, translated at the current rate.
- Inventory write-downs in translated financial statements shall not be included in the aggregate exchange gain or loss required to be disclosed pursuant to FASB Statement No. 8, but shall be reported in accordance with rules for inventory accounting set forth in Chapter 4 of ARB No. 43.
- Effective for annual and interim periods ending after March 15, 1977. Earlier application is encouraged. Retroactive application is not permitted unless it is applied with an initial application of FASB Statement No. 8.

**No. 18 – *Accounting for Income Taxes in Interim Periods*, an interpretation of APB Opinion No. 28 (March 1977)**

- Clarifies the application of APB Opinion No. 28, *Interim Financial Reporting*, with respect to accounting for income taxes in interim periods.
- The general computation requires the determination of an estimated annual effective tax rate that reflects anticipated investment tax credits, foreign tax rates, percentage depletion, capital gains rates, and other available tax planning alternatives. The rate is to be revised, if necessary, at the end of each successive interim period.
- The effective rate “. . . shall be applied to the year-to-date ‘ordinary’ income (or loss) at the end of each interim period to compute the year-to-date tax (or benefit) applicable to ‘ordinary’ income (or loss).” The interim-period tax (or benefit) related to “ordinary” income (or loss) shall be the difference between the amount so computed and the amounts reported for the previous interim periods of the fiscal year.
- The interpretation also describes the following:
  - Applications to specific situations, for example:
    - “Ordinary” income anticipated for fiscal year
      - Year-to-date income
      - Year-to-date loss

- "Ordinary" loss anticipated for fiscal year
    - Year-to-date income
    - Year-to-date loss
    - Recognition of the tax benefit of a loss
    - Reversal of net deferred tax credits
  - Tax (or benefit) applicable to significant unusual or infrequently occurring items, discontinued operations, extraordinary items, or cumulative effects of changes in accounting principles.
  - Special computations applicable to operations taxable in multiple jurisdictions.
  - Guidelines for reflecting the effects of new tax legislation.
  - Disclosure requirements.
- Effective for financial statements issued after March 31, 1977 for interim periods in fiscal years beginning after December 15, 1976. Earlier application is encouraged, but retroactive application to previously issued financial statements is not permitted.

**No. 19 — *Lessee Guarantee of the Residual Value of Leased Property*, an interpretation of FASB Statement No. 13 (October 1977) (Incorporated in the codification of FASB Statement No. 13, *Accounting for Leases*, May 1980.)**

- Deals with the determination of the amount of the lessee's guarantee of the residual value of leased property that should be included in minimum lease payments.
- Effective for leasing transactions and lease agreement revisions entered into on or after January 1, 1978. The provisions of the Interpretation shall be applied retroactively at the same time and in the same manner as the provisions of FASB Statement No. 13 are applied retroactively, except that enterprises that have already applied Statement No. 13 retroactively in published annual financial statements need not apply this Interpretation retroactively.

**No. 20 — *Reporting Accounting Changes Under AICPA Statements of Position*, an interpretation of APB Opinion No. 20 (November 1977)**

- An enterprise making a change in accounting principle to conform with the recommendations of an AICPA Statement of Position shall report the change as specified in the statement. If the AICPA statement does not specify the manner of reporting a change, an enterprise making the change shall report the change as specified by APB Opinion No. 20.
- Effective December 1, 1977.

**No. 21 — *Accounting for Leases in a Business Combination*, an interpretation of FASB Statement No. 13 (April 1978) (Incorporated in the codification of FASB Statement No. 13, *Accounting for Leases*, May 1980.)**

- Clarifies the application of Statement No. 13 in business combinations.
- Effective for business combinations that are initiated on or after May 1, 1978. The provisions of the Interpretation shall be applied retroactively at the same time and in the same manner as the provisions of FASB Statement No. 13 are applied retroactively.

**No. 22 – *Applicability of Indefinite Reversal Criteria to Timing Differences*, an interpretation of APB Opinions Nos. 11 and 23 (April 1978)**

- Specifies that the indefinite reversal concept described in APB Opinion No. 23 is not applicable to areas other than those listed in the Opinion.
  - The Interpretation does not modify APB Opinion No. 17 or the AICPA Industry Audit Guide, *Audits of Stock Life Insurance Companies*.
  - Income tax benefits resulting from amortization and depreciation of railroad gradings and tunnel bores for income tax purposes are timing differences requiring comprehensive interperiod tax allocation.
- Effective for timing differences occurring in fiscal years beginning after June 15, 1978 and to be applied prospectively.

**No. 23 – *Leases of Certain Property Owned by a Governmental Unit or Authority*, an interpretation of FASB Statement No. 13 (August 1978) (Incorporated in FASB Statement No. 13, *Accounting for Leases*, May 1980.)**

- Clarifies that portion of paragraph 28 of Statement No. 13 stating that leases of certain property owned by a governmental unit or authority shall be classified as operating leases.
- Effective for leasing transactions recorded and lease agreement revisions recorded as of December 1, 1978 or thereafter. The Interpretation shall be applied retroactively at the same time and in the same manner as the provisions of Statement No. 13, except that enterprises that have already applied Statement No. 13 retroactively in published annual financial statements need not apply the Interpretation retroactively.

**No. 24 – *Leases Involving Only Part of a Building*, an interpretation of FASB Statement No. 13, (September 1978) (Incorporated in the codification of FASB Statement No. 13, *Accounting for Leases*, May 1980.)**

- Clarifies a portion of paragraph 28 of Statement No. 13 to state that if there are no sales of property similar to the leased property, other evidence (such as an independent appraisal of the leased property or estimated replacement cost information) may provide a basis for an objective determination of fair value.
- Effective for leasing transactions recorded and lease agreement revisions recorded as of December 1, 1978 or thereafter. The Interpretation shall be applied retroactively at the same time and in the same manner as the provisions of Statement No. 13, except that enterprises that have already applied Statement No. 13 retroactively in published annual financial statements need not apply the Interpretation retroactively.

**No. 25 – *Accounting for an Unused Investment Tax Credit*, an interpretation of APB Opinions Nos. 2, 4, 11, and 16 (September 1978)**

- Clarifies the circumstances, if any, under which an enterprise shall recognize the benefit of an investment tax credit prior to its realization as an offset against federal income tax liability.

- An investment tax credit becoming available in the current period, or carried forward from a prior period, shall be recognized to the extent that the benefit would have been realized if taxes payable had been based on pretax accounting income adjusted for permanent differences.
  - Any remaining unused investment tax credit shall be offset against existing net deferred tax credits to the extent of deferred credits that would reverse during the investment tax credit carryforward period, subject to certain limitations.
  - The guidelines set forth in APB Opinion No. 11, *Accounting for Income Taxes*, that permit recognition of net operating loss carryforwards when realization is assured beyond any reasonable doubt do not apply to recognition of unused investment tax credits.
  - When the tax benefit of an unused investment tax credit that was recognized is subsequently realized as a reduction of federal income taxes payable, an equivalent amount of deferred tax credits shall be recorded.
- The Interpretation does not apply to companies that recognize the tax benefits of investment credits only to the extent realized as a reduction of federal income taxes payable and defer and amortize those credits over the life of the related property.
- Unused investment credits acquired in a purchase combination shall reduce goodwill recognized in the combination in the period in which the investment credits are realized as an offset to federal income taxes payable. Goodwill (and any amortization thereof) shall not be adjusted retroactively.
  - Special provisions apply when realized investment credits exceed the remaining unamortized goodwill recognized in the business combination.
- Effective for investment tax credits arising in fiscal years beginning after December 15, 1978 and to be applied prospectively. Unused investment credits arising in earlier years shall be accounted for according to methods presently used.
  - Special provisions apply to accounting for unused investment tax credits acquired in purchase combinations.

**No. 26 — *Accounting for Purchase of a Leased Asset by the Lessee During the Term of the Lease*, an interpretation of FASB Statement No. 13 (September 1978) (Incorporated in the codification of FASB Statement No. 13, *Accounting for Leases*, May 1980)**

- The termination of a capital lease that results from the purchase of a leased asset does not give rise to a gain or loss but rather is an integral part of the purchase of the leased asset.
- Effective for purchases of leased property recorded as of December 1, 1978 or thereafter. The Interpretation shall be applied retroactively at the same time and in the same manner as the provisions of Statement No. 13, except that enterprises that have already applied Statement No. 13 in published annual financial statements need not apply the Interpretation retroactively.

**No. 27 — *Accounting for a Loss on a Sublease*, an interpretation of FASB Statement No. 13 and APB Opinion No. 30 (November 1978) (Incorporated in the codifications of FASB Statement No. 13, *Accounting for Leases*, May 1980)**

- Statement No. 13 does not eliminate the need to recognize a loss on a sublease in those situations in which paragraphs 15-17 of APB Opinion No. 30, *Reporting the Results of Operations*, require the recognition of the loss.



- Effective for estimates of losses at the measurement date (see paragraph 14 of APB Opinion No. 30 for the definition of the measurement date) of a disposal occurring on or after March 1, 1979 and for subleases recorded as of March 1, 1979 or thereafter. Retroactive application is required in accordance with paragraphs 49 and 51 of Statement No. 13.

**No. 28 — *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans*, an interpretation of APB Opinions Nos. 15 and 25 (December 1978)**

- Clarifies when an enterprise shall record compensation expense related to stock appreciation rights and awards under other compensation plans with variable terms (i.e., plans for which the number of shares of stock the employees may receive, the price per share the employees must pay, or both the number of shares and the price are unknown at the date of grant or award) and how the enterprise shall compute that compensation expense.
- Specifies that when stock appreciation rights or other variable plan awards are granted, an enterprise shall measure compensation as the amount by which the quoted market value of the shares covered by the grant exceeds the option price or value specified under the plan, subject to any limitations under the plan.
  - Changes in the quoted market value of the shares between the date of grant and the measurement date (the first date on which both (1) the number of shares that an individual employee is entitled to receive, and (2) the option or purchase price, if any, are known) result in a change in the measure of compensation.
- Compensation shall be accrued over the period or periods the employee performs the related services.
  - Grants made for past services shall be accrued as a charge to expense of the period in which the rights or awards are granted.
  - Up to the measurement date, accrued compensation shall be adjusted in subsequent periods for changes in the quoted market value of the shares, but shall not be adjusted below zero.
  - The offsetting adjustment shall be made to compensation expense of the period in which the change occurs.
- Guidelines are set forth for accounting for combination plans.
- Stock appreciation rights and other variable plan awards are common stock equivalents for purposes of applying the provisions of APB Opinion No. 15, *Earnings Per Share*, to the extent they are payable in stock.
- Effective for stock appreciation rights and other variable plan awards granted in fiscal years beginning after December 15, 1978. The Interpretation shall not be applied retroactively.
  - An accrual of compensation expense or an adjustment of accrued compensation resulting from the application of this Interpretation for rights and awards granted in fiscal years beginning before December 16, 1978 shall be accounted for as a change in estimate in the period of change.

**No. 29 — *Reporting Tax Benefits Realized on Disposition of Investments in Certain Subsidiaries and Other Investees*, an interpretation of APB Opinions Nos. 23 and 24 (February 1979)**

- Clarifies the reporting of income tax benefits realized by an investor from the disposition of an investment in certain subsidiaries and other investees.
- An investor shall classify tax benefits realized on disposition of an investment relating to a difference between the accounting basis and the tax basis of the investment in the subsidiary or other investee in the same manner as the classification accorded to gain or loss on disposition of the investment.
  - Disclosure shall be made if application of this Interpretation creates a significant variation in the customary relationship between income tax expense and pretax accounting income.
- Effective for dispositions occurring after March 1, 1979. Reclassification in previously issued financial statements is permitted but not required.

**No. 30 — *Accounting for Involuntary Conversions of Nonmonetary Assets to Monetary Assets*, an interpretation of APB Opinion No. 29 (September 1979)**

- Specifies that involuntary conversions of nonmonetary assets to monetary assets are monetary transactions for which gain or loss should be recognized even though an enterprise reinvests or is obligated to reinvest the monetary assets in replacement nonmonetary assets.
- Gain or loss should be recognized in accordance with FASB Statement No. 5, *Accounting for Contingencies*, if monetary assets are received in a period subsequent to the period when the nonmonetary assets were destroyed or damaged.
- Gain or loss resulting from an involuntary conversion of a nonmonetary asset to monetary assets shall be classified in accordance with the provisions of APB Opinion No. 30, *Reporting the Results of Operations — Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*.
- Effective for involuntary conversions of nonmonetary assets to monetary assets occurring in fiscal years beginning after November 15, 1979. Earlier application is encouraged for fiscal years beginning before November 16, 1979 for which financial statements have not been previously issued.

**No. 31 — *Treatment of Stock Compensation Plans in EPS Computations*, an interpretation of APB Opinion No. 15 and a modification of FASB Interpretation No. 28 (February 1980)**

- Clarifies the provisions of FASB Interpretation No. 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans*, that discuss the dilutive effect in EPS computations of stock appreciation rights and other variable plan awards.
- In applying the treasury stock method to stock options, including stock appreciation rights and other variable plan awards, the exercise proceeds of the options are the sum of the amount the employee must pay, the amount of measurable compensation ascribed to future services and not yet charged to expense (whether or not accrued), and the amount of any "windfall" tax benefit to be credited to capital.
  - Exercise proceeds shall not include compensation ascribed to past services.
- Provides guidance for computing primary and fully diluted earnings per share.
- Provisions cover EPS treatment of combination plans that allow an employer or employee to choose among various alternative stock option or stock right awards.

- Effective for financial statements for fiscal years beginning after December 15, 1979. Earlier application is encouraged.
  - The Interpretation may be, but is not required to be, applied retroactively to previously issued financial statements.

**No. 32 — *Application of Percentage Limitations in Recognizing Investment Tax Credit, an interpretation of APB Opinions Nos. 2, 4 and 11 (March, 1980)***

- Clarifies the application of paragraph 10 of FASB Interpretation No. 25, *Accounting for an Unused Investment Tax Credit*, with respect to the statutory limitation to be used in recognizing unused investment tax credit.
  - The Revenue Act of 1978 changed the statutory percentage limitations that determine the extent to which federal income tax otherwise payable may be offset by investment tax credit.
- The statutory limitations to be used are as follows:
  - In the “with-and-without” computation — the statutory percentage limitations in effect for the year the computation is being made, and
  - In recognizing investment tax credit in addition to that recognized in the “with-and-without” computation — the statutory percentage limitations applicable to the years in which previously recorded deferred tax credits are expected to reverse.
- In recognizing investment tax credit in addition to that recognized in the “with-and-without” computation the following rules must be observed:
  - Only net deferred tax credits that have not been previously offset and that will reverse during the investment tax credit carryforward period, disregarding any timing differences that may originate in that carryforward period, shall be offset by investment tax credit.
  - Net deferred tax credits offset by investment tax credit in prior years shall not be adjusted to reflect changes in the statutory percentage limitations.
- Effective for recognition of investment tax credit in fiscal year beginning after December 15, 1979.
  - Earlier application is encouraged in financial statements for fiscal years beginning before December 16, 1979 that have not been previously issued; however, if the provisions of the Interpretation are adopted early, previously issued financial information for any interim periods of that fiscal year that precede the period of adoption shall be restated.
  - The Interpretation shall not be applied retroactively for previously issued annual financial statements.

**No. 33 — *Applying FASB Statement No. 34 to Oil and Gas Producing Operations Accounted for by the Full Cost Method, an interpretation of FASB Statement No. 34 (August 1980)***

- Clarifies the application of FASB Statement No. 34, *Capitalization of Interest Cost*, to the operations of enterprises that use the full cost method of accounting for oil and gas operations.
- Assets whose costs are being currently depreciated, depleted or amortized are assets in use in the earning activities of the enterprise and are not assets qualifying for capitalization of interest cost.

- Unusually significant investments in improved properties and major development projects that are not being currently depreciated, depleted or amortized, and on which exploration or development activities are in progress, are assets qualifying for interest capitalization.
  - In a cost center with no production, projects in process qualify for capitalization of interest.
- Effective for annual financial statements for fiscal years beginning after December 15, 1979 and for interim periods within those fiscal years.
- Earlier application is encouraged.
  - Restatement of earlier years is encouraged but not required.
  - Special disclosure requirements apply if restatement of prior years is not made.

## TECHNICAL BULLETINS ISSUED

### *79-1 – Purpose and Scope of FASB Technical Bulletins and Procedures for Issuance* (December 28, 1979)

- Specifies that the FASB has authorized its staff to issue *FASB Technical Bulletins* to provide guidance on certain financial accounting and reporting problems on a timely basis.
- Technical Bulletins provide guidance concerning the application of official pronouncements, FASB Statements or Interpretations, APB Opinions, or Accounting Research Bulletins.
  - Technical Bulletins are not Statements or Interpretations to which Rule 203 applies.
  - Technical Bulletins do not establish new financial accounting and reporting standards nor amend existing standards.
  - Technical Bulletins generally address implementation questions heretofore covered by FASB letter communications.
- Technical Bulletins will be used in the following circumstances:
  - The intent of the underlying standard is documented or known to the staff and the answer does no more than clarify, explain, or elaborate upon the underlying standard.
  - The answer is not expected to have a significant effect on either financial reporting in general or most organizations affected by the underlying standard.
  - The administrative cost that may be involved in implementing the answer is not expected to be significant to most affected organizations.
- Technical Bulletins are not approved by the Board, but Board members are informed of all matters proposed for Bulletins and receive copies of all proposed Bulletins prior to issuance.
  - The Director of Research and Technical Activities may expose proposed Technical Bulletins for comment prior to issuance.
- Technical Bulletins are issued in question and answer format.

### *79-2 – Computer Software Costs* (December 28, 1979)

### *79-3 – Subjective Acceleration Clauses in Long-Term Debt Agreements* (December 28, 1979)

### *79-4 – Segment Reporting of Puerto Rican Operations* (December 28, 1979)

### *79-5 – Meaning of the Term “Customer” as It Applies to Health Care Facilities Under FASB Statement No. 14* (December 28, 1979)

### *79-6 – Valuation Allowances Following Debt Restructuring* (December 28, 1979)

### *79-7 – Recoveries of a Previous Writedown Under a Troubled Debt Restructuring Involving a Modification of Terms* (December 28, 1979)

### *79-8 – Applicability of FASB Statements 21 and 33 to Certain Brokers and Dealers in Securities* (December 28, 1979)

*79-9 – Accounting in Interim Periods for Changes in Income Tax Rates (December 28, 1979)*

*79-10 – Fiscal Funding Clauses in Lease Agreements (December 28, 1979)*

*79-11 – Effect of a Penalty on the Term of a Lease (December 28, 1979)*

*79-12 – Interest Rate Used in Calculating the Present Value of Minimum Lease Payments (December 28, 1979)*

*79-13 – Applicability of FASB Statement No. 13 to Current Value Financial Statements (December 28, 1979)*

*79-14 – Upward Adjustment of Guaranteed Residual Values (December 28, 1979)*

*79-15 – Accounting for Loss on a Sublease Not Involving the Disposal of a Segment (December 28, 1979)*

*79-16 – Effect of a Change in Income Tax Rate on the Accounting for Leveraged Leases (December 28, 1979) (Revised, February 29, 1980)*

*79-17 – Reporting Cumulative Effect Adjustment from Retroactive Application of FASB Statement No. 13 (December 28, 1979)*

*79-18 – Transition Requirement of Certain FASB Amendments and Interpretations of FASB Statement No. 13 (December 28, 1979)*

*79-19 – Investor's Accounting for Unrealized Losses on Marketable Securities Owned by an Equity Method Investee (December 28, 1979)*

*80-1 – Early Extinguishment of Debt Through Exchange for Common or Preferred Stock (December 19, 1980)*

*80-2 – Classification of Debt Restructurings by Debtors and Creditors (December 19, 1980)*

## EXPOSURE DRAFTS ISSUED AND OUTSTANDING

### Proposed Statements of Concepts

### Proposed Statements of Standards

*Foreign Currency Translation* (Issued August 28, 1980; public hearings held on December 17-19, 22, 1980)

- Revises the standards of financial accounting and reporting for foreign currency transactions and for translating foreign currency financial statements.
  - Translation for purposes other than consolidation, combination, or the equity method is beyond the scope of this Statement.
  - Supersedes the following:
    - FASB Statement Nos. 8, *Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements*, and 20, *Accounting for Forward Exchange Contracts*.
    - FASB Interpretation Nos. 15, *Translation of Unamortized Policy Acquisition Costs by a Stock Life Insurance Company*, and 17, *Applying the Lower of Cost or Market Rule in Translated Financial Statements*.
- Translation should accomplish the following objectives:
  - Preserve the financial results and relationships as measured and expressed in the functional currency of each component entity of an enterprise.
  - Ensure that the translation results are generally compatible in terms of direction of change and financial statement classification with the expected effects of a rate change on an enterprise's exposure to foreign exchange risk.
- Foreign currency statements shall be translated as follows:
  - Prior to translation, foreign currency statements that are to be included in a U.S. enterprise's financial statements shall be prepared in conformity with U.S. generally accepted accounting principles. The assets, liabilities, and operations of an entity shall be measured using the functional currency of that entity.
    - An entity's functional currency is the primary currency of the economic environment in which the entity generates and expends cash.
      - There is a presumption that the functional currency is the currency of the country in which the entity is located.
      - Ordinarily the books and records are maintained in the functional currency.
    - Foreign operations that are a direct and integral component or extension of an enterprise's operations in the United States are operations for which the functional currency might be the U.S. dollar. This situation might exist where:
      - The U.S. operations are the principal source of financing for the foreign entity.
      - Changes in the foreign assets and liabilities impact directly on the dollar cash flows of the reporting enterprise.
  - All of a foreign entity's assets and liabilities shall be translated from that entity's functional currency into the reporting currency by using the current exchange rate.

- The current rate is the rate in effect at the balance sheet date.
  - Procedures are specified if multiple rates exist or if a foreign entity's balance sheet date differs from that of the parent or controlling enterprise.
  - Translation of a foreign entity's revenues, expenses, gains, and losses may be made by using an appropriately weighted average exchange rate for the period.
  - Adjustments resulting from the translation process shall not be included in determining net income.
- Adjustments shall be accumulated in a separate component of stockholders' equity until substantial or complete liquidation occurs or until a permanent impairment of the net investment has taken place.
- Foreign currency transactions produce foreign currency cash or foreign currency receivables and payables that are fixed in terms of the amount of foreign currency that will be received or paid.
  - A change in exchange rate increases or decreases the expected functional currency cash flows and is an exchange gain or loss that generally shall be included in determining net income for the period in which the rates change.
  - Exceptions to the above rule apply where:
    - Foreign currency transactions are intended to be an economic hedge of a net investment.
    - Exchange gains or losses are attributable to foreign currency transactions between an investor and investee entity, when the latter is consolidated, combined, or accounted for under the equity method.
    - Forward exchange contracts are intended to be a hedge of an identifiable foreign currency commitment. Detailed rules are set forth for forward exchange contracts.
  - Where the exception applies, the gain or loss is to be accumulated in a separate component of stockholders' equity.
- The accumulated adjustment resulting from translation is realized in full or in part upon complete or substantial liquidation of that investment.
  - The amount realized shall be removed from the accumulated translation adjustment account in stockholders' equity and included as an exchange gain or loss in income in the period the liquidation occurs.
- A permanent impairment of a net investment may also result in realization of a portion of the accumulated adjustment account.
- Interperiod tax allocation is required if taxable exchange gains or tax deductible exchange losses are included in income in a different period for financial statement purposes than for tax purposes.
  - Notwithstanding that adjustments resulting from translation are not reported in income, an allocation for deferred taxes shall be made if they otherwise meet the criteria of APB Opinion No. 11, *Accounting for Income Taxes*, and are called for under the provisions of APB Opinion Nos. 23, *Accounting for Income Taxes – Special Areas*, and 24, *Accounting for Income Taxes – Investments in Common Stock Accounted for by the Equity Method*.



- The provision for deferred income taxes in this instance shall be allocated to the separate component of stockholders' equity and shall not be an increase or decrease of income tax expense for the period.
- Disclosure requirements include the following:
  - The aggregate exchange gain or loss included in determining net income for the period.
  - The effect of rate changes on reported results of operations, other than the effects included in the disclosure required above, quantified if practicable.
  - An analysis of the separate component of stockholders' equity for the period.
  - Rate changes after the date of the financial statements, and the effects on foreign currency transactions, if significant.
    - An enterprise's financial statements shall not be adjusted for rate changes that occur after the date of the financial statements.
- The proposed Statement would be effective for fiscal years beginning on or after December 15, 1981.
  - Earlier application is encouraged.
  - Financial statements and summaries for periods before the effective date may be restated.
  - In the year this Statement is first applied, the nature of any restatement and its effect on earnings and related per share amounts shall be disclosed.
  - If the prior year is not restated, disclosure of income before extraordinary items and net income for the prior year computed on a pro forma basis is encouraged.
  - The aggregate effect on shareholders' equity as of the beginning of the year for which this Statement is first applied shall be reported as the opening balance of the separate component of stockholders' equity.
  - Disclosures called for by this Statement, to the extent practicable, shall also be made for earlier periods that have been restated.

(Comment period ended December 1, 1980)

*Disclosure of Interest Rate Futures Contracts and Forward and Standby Contracts* (November 14, 1980)

- Specifies the disclosures required for interest rate futures contracts and forward and standby contracts involving financial instruments until related accounting issues can be resolved.
- Would be effective for fiscal years ending after December 15, 1980.

(Comment period ended December 15, 1980)

Note: At the January 7, 1981 meeting of the Board, it decided, tentatively, not to continue this project.

*Disclosure of Obligations: Disclosure of Unconditional Obligations* (November 14, 1980)

- Clarifies the accounting for project financing arrangements, take-or-pay contracts, throughput contracts, and other unconditional obligations similar to those typically associated with project financing arrangements.

- Defines an unconditional obligation as an obligation to transfer funds that is not dependent on the occurrence of any significant event or the fulfillment of any important condition.
  - An obligation is considered unconditional even though it is cancellable under circumstances such as:
    - Having the permission of the other party.
    - The occurrence of some remote contingency.
    - The signing of a replacement agreement between the same parties.
    - Payment of a penalty in an amount such that continuation of the agreement appears reasonably assured.
- The Statement does not alter the accounting treatment for certain unconditional obligations that are presently recorded as liabilities on participants' balance sheets or the treatment of future obligations that are substantially the same as those obligations already recorded as liabilities.
- For obligations that are recognized on balance sheets, the following information shall be disclosed, as of the latest balance sheet presented, for each of the five succeeding fiscal years:
  - The combined aggregate amount of maturities and sinking fund requirements for all long-term borrowings.
  - The combined aggregate amount of redemption requirements for all issues of capital stock that are redeemable at fixed or determinable prices on fixed or determinable dates.
  - The aggregate amount of payments for take-or-pay contracts, throughput contracts, or similar unconditional obligations that have been recognized on balance sheets.
- As an interim measure, pending further work on certain phases of the Conceptual Framework project, the Board has concluded that unconditional obligations including take-or-pay contracts and throughput contracts that have not been recognized on balance sheets, exclusive of those listed below, shall be disclosed as follows:
  - A brief description of the nature of the obligation(s) and relationship of the obligee(s) to the obligor.
  - The amount of the fixed and determinable obligation(s) as of the date of the latest balance sheet in the aggregate and, if determinable, for each of the five succeeding fiscal years.
  - A description of the nature of any variable component of the obligation(s).
  - Disclosure of the amount of imputed interest necessary to reduce the obligation(s) to present value is encouraged but not required.
    - Discount rates to be used are specified.
- Disclosures specified above are not required with respect to obligations:
  - Recorded as liabilities.
  - For the primary benefit of employees, such as salaries and pensions.

- To pay taxes.
- For purchase commitments.
- For items classified as leases under FASB Statement No. 13, *Accounting for Leases*.
- Would be effective for fiscal years ending after June 15, 1981.
  - Earlier application is encouraged.

(Comment period ended January 15, 1981)

*Accounting for Franchise Fee Revenue* (December 1, 1980)

- Extracts the specialized principles and practices from the AICPA Industry Accounting Guide, *Accounting for Franchise Fee Revenue*, and establishes accounting and reporting standards for fee revenue that is obtained through a franchise agreement.
- Specifies that franchise fee revenue from an individual franchise sale ordinarily shall be recognized (with an appropriate provision for estimated uncollectible amounts) when all material services or conditions relating to the sale have been substantially performed or satisfied by the franchisor.
  - Substantial performance means that:
    - The franchisor has no remaining obligation or intent — by agreement, trade practice or law — to refund any cash received or forgive any unpaid notes or receivables.
    - Substantially all of the initial services of the franchisor required by the franchise agreement have been performed.
    - No other material conditions or obligations related to the determination of substantial performance exist.
- Other areas covered include:
  - Area franchise sales.
  - Use of installment accounting methods.
  - Relationships between franchisor and franchisee.
  - Commingled revenue.
  - Continuing franchise sales.
  - Continuing product sales.
  - Agency sales.
  - Franchising costs.
  - Reacquired franchises.
  - Business combinations.
  - Disclosures.
- Would be effective for fiscal years beginning after June 15, 1981.
  - Earlier application is encouraged.
  - The provisions of this Statement shall be applied retroactively and any accompanying financial statements presented for prior periods shall be restated.

(Comment period ended January 30, 1981)

### **Proposed Interpretations**

#### ***Applicability of APB Opinion No. 21 to Television Film License Agreements, an interpretation of APB Opinion No. 21 (September 28, 1979)***

- Concludes that APB Opinion No. 21, *Interest on Receivables and Payables*, applies to receivables and payables arising from television film license agreements.
  - Interest should be imputed if such agreements have terms that exceed approximately one year and have either no stated interest rate or a stated interest rate that varies from prevailing interest rates.
- Would be effective upon issuance. Application would be retroactive by restating the financial statements of prior periods.

(Comment period ended November 30, 1979)

(The Board decided on January 23, 1980 to defer action until later when the matter will be considered with the specialized accounting principles and practices.)

#### ***Accounting by Oil and Gas Producing Companies for the Tax Benefits of Percentage Depletion, an interpretation of FASB Statement No. 19 (July 31, 1980)***

- Clarifies certain provisions of FASB Statement No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies*, as it relates to accounting for the tax benefits of the excess of percentage depletion over cost depletion otherwise allowable as a tax deduction.
- Would be effective for financial statements for fiscal years beginning after December 15, 1980.

(Comment period ended October 31, 1980)

Note: At the January 7, 1981 meeting of the Board, it decided, tentatively, not to continue with this project.

#### ***Disclosure of Obligations: Disclosure of Indirect Guarantees of Indebtedness of Others, an interpretation of FASB Statement No. 5 (November 14, 1980)***

- States that the term "guarantees of indebtedness of others" in paragraph 12 of FASB Statement No. 5, *Accounting for Contingencies*, includes indirect guarantees of indebtedness of others.
- An indirect guarantee arises under an agreement that obligates one entity to transfer funds to a second entity upon the occurrence of specified events, under conditions whereby:
  - The funds are legally available to creditors of the second entity.
  - The creditors may enforce the second entity's claims against the first entity under the agreement.
- Examples of indirect guarantees include:
  - Agreements to advance funds if a second entity's income coverage of fixed charges or working capital falls below a specified minimum.
  - A general partner's responsibility for the indebtedness of a partnership.
- Would be effective for fiscal years ending after June 15, 1981.
  - Earlier application is encouraged.

(Comment period ended January 15, 1981)

***Accounting for Exploratory Wells in Progress at the End of a Period, an interpretation of FASB Statement No. 19 (November 26, 1980)***

- Specifies that if an exploratory well or exploratory-type stratigraphic test well is in progress at the end of a period and the well is determined not to have found proved reserves (i.e., determined to be a dry hole) before the financial reports for that period are issued, the costs incurred through the end of the period, net of any salvage value, shall be charged to expense for that period.
- Would be effective for fiscal years beginning after June 15, 1981 and for interim accounting periods within those fiscal years.
  - Earlier application is encouraged.

(Comment period ends February 25, 1981)

***Criteria for Applying the Equity Method of Accounting for Investments in Common Stock, an interpretation of APB Opinion No. 18 (December 19, 1980)***

- Clarifies the criteria for applying the equity method of accounting for investments of 50 percent or less of the voting stock of an investee enterprise (other than a corporate joint venture).
  - Paragraph 17 of APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*, states that 20 percent or more of the voting stock of an investee should lead to a presumption that in the absence of evidence to the contrary an investor has the ability to exercise significant influence over an investee.
- This Interpretation clarifies that the presumptions are to be applied using judgment. The presumptions remain in place unless they are overcome by sufficient evidence to the contrary.
- Evidence that an investor owning 20 percent or more may be unable to exercise significant influence over the investee's operating and financial policies requires an evaluation of all the facts and circumstances relating to the investment.
  - Example of indications of such inability include:
    - The investee asserts that the investor is unable to exercise significant influence by filing a lawsuit, making a complaint to appropriate governmental regulatory authorities, or other means.
    - The investor and investees sign a standstill agreement under which the investor surrenders significant rights as a shareholder.
    - Majority ownership is concentrated among a small group of shareholders who operate the investee without regard to the views of the investor.
    - The investor is unable to obtain the financial information necessary to apply the equity method.
    - The investee tries and fails to obtain representation on the investee's board of directors.

- The list is illustrative and not all-inclusive. None of the individual factors is conclusive, but if any of those or similar factors are present an investor with ownership of 20 percent or more shall evaluate all facts and circumstances relating to the investment to reach an appropriate judgment.
- Would be effective for fiscal years beginning after June 25, 1981.
- Earlier application is encouraged.
  - Changes in the method of accounting for investments required by this interpretation would be in accordance with paragraphs 19(l) and (m) of APB Opinion No. 18.

**Proposed Technical Bulletins**

80-C — Current Cost of Motion Picture Films.

80-D — Classification as Monetary or Nonmonetary Items.

80-E — Multiemployer Pension Plans Amendment Act of 1980.

80-F — Offsetting Interest Cost to be Capitalized with Interest Income.

## DISCUSSION MEMORANDA ISSUED—For which Exposure Drafts have not been issued to date

### Concepts

***Criteria for Determining Materiality*** (Issued March 1975, public hearing held May 20, 1976)  
(The project has been combined with the *Qualitative Characteristics* project.)

- The objective of the Board is to establish materiality criteria which, when applied, will result in consistent financial reporting of matters necessary for an understanding of an enterprise's financial activities. Such criteria should be capable of practical application to various types of items in varying circumstances.
- The scope of this project is limited to consideration of criteria for determining materiality applicable only to the general purpose financial statements of profit-oriented enterprises.
- Focus is on materiality in financial accounting and reporting. However, the results of the project may be useful in any consideration of materiality in auditing.
- The Discussion Memorandum is developed along two major lines of inquiry:
  - To provide users an overview of the complexities of the accounting and reporting process and of the resulting practical difficulties confronting those who make decisions involving the determination of materiality, and
  - To provide preparers and auditors with an overview of the needs and expectations of the primary users of financial statements.
- The basic issues set forth in the Discussion Memorandum focus on the orientation and frame of reference, and the level of specificity of criteria for determining materiality as well as the mode of expression of the criteria—for example, quantitative, qualitative or some combination of the two. Implementation issues are set forth to elicit comments helpful in developing specific criteria.

***Conceptual Framework for Financial Accounting and Reporting: Elements of Financial Statements and Their Measurement*** (Issued December 2, 1976, public hearings held on Part I on August 1, 1977 and on Parts II and III on January 16, 1978)

- The Board's project on a conceptual framework for financial accounting and reporting is a major, continuing project that is being carried out in several phases.
- The Discussion Memorandum contains no conclusions of the Board. The Memorandum is divided into three parts:
  - Defining the elements of financial statements (Part I).
  - Identifying the qualitative characteristics of financial information (Part II).
  - Selecting the attributes of the elements that should be measured (Part III).
- Part I relates to the definition of the elements of financial statements.
  - One of the critical issues is the conceptual view of earnings. Two principal conceptual views of earnings are advanced:
    - The asset and liability view, under which earnings are determined as a measure of the change in net economic resources.
    - The revenue and expense view, which focuses on the matching process and on revenue and expense measurement.

- Statement of Financial Accounting Concepts No. 3, *Elements of Financial Statements of Business Enterprises*, December 1980, was issued on this part. However, it deferred defining "earnings" until a later phase of the Conceptual Framework project.
- Part II concentrates on the qualitative characteristics of financial information. Of special concern is how qualities that are already widely accepted can become effective criteria or standards.
  - Statement of Financial Accounting Concepts No. 2, *Qualitative Characteristics of Accounting Information*, May 1980, was issued on this part.
- Part III deals with the measurement of the elements of financial statements and focuses on the selection of the attributes of those elements that are to be measured and the selection of the unit of measurement.
  - FASB Statement No. 33, *Financial Reporting and Changing Prices*, and FASB Statement Nos. 39-41, *Financial Reporting and Changing Prices: Specialized Assets*, are considered by the Board to be phases of the measurement project.
  - No Exposure Draft has been issued on the concepts for measurement of the elements of financial statements.

***Reporting Earnings (Issued July 31, 1979, public hearings held on December 3 and 4, 1979)***

- The project on reporting earnings focuses mainly on questions of disclosure. It raises issues concerning disclosure of components of earnings not now displayed, and the exclusion of some components of earnings from the computation of net earnings for the current year.
  - The main purpose of the Discussion Memorandum is to consider whether the benefits of additional disclosures may exceed the associated costs.
  - The project overlaps two other projects of the Board:
    - Financial Statements/Financial Reporting
    - Reporting Funds Flow and Liquidity
  - The concept of earnings used in this project is the increase in net assets or owners' equity from all transactions and other events and circumstances affecting the enterprise during the period, excluding the effects of certain transactions with owners.
- The applicability of the conclusions of FASB Statement of Financial Accounting Concepts No. 1, *Objectives of Financial Reporting by Business Enterprises*, to the reporting of information on earnings is discussed to derive criteria for deciding which reporting alternatives are to be preferred.
  - Specific attention is devoted to various user needs, such as:
    - Assessing the volume of regular activities and the revenues generated by those activities.
    - Assessing earnings from regular activities, which requires the assessment of regular expenses.
    - Information about irregular revenues, expenses, gains, and losses.
  - Additional consideration is given to the form of presentation and to summary indicators and ratios, such as earnings-per-share information and rates on capital employed.
- The nine specific issues raised in the Discussion Memorandum deal with such matters as:
  - The detail in which volume of activity and regular revenues is to be reported.



- The manner of reporting regular expenses; for example, as fixed and variable, or in functional categories.
  - The criteria to be used for identifying irregular revenues, expenses, gains and losses.
  - Single-step versus multiple-step income statements.
  - The exclusion of any components of earnings from the earnings statement for the current period, and inclusion of them in a separate statement or as a direct adjustment to equity interest.
  - The presentation of a five-year summary of earnings.
- Two advisory issues included in the Discussion Memorandum deal with certain aspects of cash flow reporting and the reporting of an earnings forecast.

**Reporting Funds Flows, Liquidity, and Financial Flexibility (Issued December 15, 1980, public hearings to be held May 11, 12, 13, 1981)**

- The Discussion Memorandum focuses on the issues relating to the reporting of information on past funds flows, liquidity, and financial flexibility:
- How the information is useful.
  - What information would be most useful.
  - How the information should be presented.
- The project was undertaken by the Board for the following reasons:
- Users of financial information have shown increased interest in the information.
  - Concern has been expressed about the effectiveness of existing practices of reporting.
  - The project forms an integral part of the development of the Board's Conceptual Framework project.
- Among the issues to which respondents are urged to reply are the following:
- Should presentation of a funds statement continue to be required and should the requirement extend to all types of enterprises?
  - What concept of funds should be adopted as the focus of the funds flows statement?
    - Working capital?
    - Net current monetary assets?
    - Cash and short-term investments?
    - Cash?
  - Should the FASB prescribe one particular reporting format for the funds statement?
    - Consideration should be given to:
      - Dividing funds flows into two categories: sources and uses.
      - Dividing funds flows into three categories: operating activities, investing activities, financing activities.
      - Grouping items to highlight certain components of funds flows, such as funds provided by continuing operations, and funds associated with extraordinary items.
      - The criteria for determining the individual line items to be reported in the funds statement.

- Should information be provided about funds flows of segments of an enterprise?
- Should there be one or more financial statements, apart from the funds statement, reporting changes in asset structure and financial structure?
- Should supplementary information about the effects of changing prices include information about the effects on the funds available for expansion and distribution?
- Should financial reports provide information about the liquidity of assets and liabilities?
- Should financial reports provide information about the financial flexibility of an enterprise?

### **Standards**

#### ***Accounting for Research and Development and Similar Costs* (Issued December 28, 1973, public hearing held on March 15, 1974)**

- The parts dealing with research and development costs resulted in FASB Statement No. 2, *Accounting for Research and Development Costs*.
- The parts dealing with development stage companies are dealt with in FASB Statement No. 7, *Accounting and Reporting by Development Stage Enterprises*.
- The parts dealing with "Similar Costs" have not yet resulted in any action by the FASB. These deal primarily with preoperating and plant start-up costs, market research, product promotion costs, plant relocations, assembly-line rearrangements, hotel and store opening costs, and other costs (such as insurance acquisition costs). The Board announced that it has no plans at this time for further deliberations on costs similar to R&D. Such consideration is to await completion of the Conceptual Framework for accounting and reporting.

#### ***Accounting for Business Combinations and Purchased Intangibles* (Issued August 19, 1976; the public hearing originally scheduled for May 1977 was cancelled and will be rescheduled some time after the issuance of a Statement on elements of financial statements of business enterprises)**

- The objective of this project is to determine appropriate financial accounting and reporting standards for business combinations and purchased intangibles within the existing framework of historical-cost financial statements.
- The memorandum is divided into three levels.
- The first level deals with basic and implemental issues involving choices about alternative procedures for giving effect to conceptual decisions, including such basic issues as:
  - How should the identifiable assets and liabilities of the constituent companies be accounted for in the combined enterprise's financial statements?
  - How should positive goodwill be accounted for in a combination?
  - How should the excess of the current value of a constituent company's net identifiable assets over the aggregate cost for that company be accounted for?
  - How should purchased intangibles be accounted for?

A series of implementation issues surrounds these basic issues.

- The second level of the memorandum addresses technical issues or aspects of applying accounting standards to specific business combinations, including such matters as income tax accounting, treatment of contingent consideration, treatment of accounting changes, etc.

- The third level of the memorandum includes ten appendices that provide background or detailed information related to various issues.

***Interim Financial Accounting and Reporting* (Issued May 25, 1978, public hearing held on September 26, 1978. Project is inactive. Future work will be determined after the issuance of a Statement on elements of financial statements of business enterprises.)**

- The central objective of this project is to determine appropriate accounting and reporting standards for financial statements and summarized financial data covering periods shorter than a year.
- The scope of the project embraces all issues considered in APB Opinion No. 28, *Interim Financial Reporting*, FASB Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements*, and FASB Interpretation No. 18, *Accounting for Income Taxes in Interim Periods*, and other relevant issues such as interim period segment information disclosure and prior period adjustments.
  - Any resulting Statement would not modify accounting standards for an annual period.
  - Measurement alternatives to be considered are limited to those found under the present accounting model.
  - The project will not modify the provisions of the Addendum to APB Opinion No. 2, *Accounting for the "Investment Credit,"* but additional disclosures may be required of covered industries.
- The Discussion Memorandum addresses eight basic issues:
  - The objectives, uses, elements, and qualitative characteristics of interim financial reports versus those of annual reports.
  - Interim period expense recognition and measurement.
    - Interim period viewed as an integral part of an annual period.
    - Interim period viewed as a discrete segment of history.
    - Adoption of both integral and discrete viewpoints, with selective application to different types of transactions or events.
  - Determination of interim inventory under LIFO.
  - Basis of provision for estimated interim period income taxes.
    - Estimated effective tax rate for the year.
    - Income tax expense applicable to interim period income.
    - Some combination of the two methods.
  - Treatment of prior period adjustments.
  - Interim period disclosure requirements.
  - Applicability of interim period reporting requirements to different business enterprises; for example, all enterprises, only publicly held enterprises, etc.
  - Application of a standard on a retroactive or prospective basis.

***Effect of Rate Regulation on Accounting for Regulated Enterprises* (Issued December 31, 1979; public hearings held on May 28 and 29, 1980)**

- The Discussion Memorandum focuses on the effect of rate regulation on financial accounting and reporting for enterprises whose prices are regulated by governmental agencies.

- Although the primary emphasis is on public utilities and health care organizations, consideration is also given to other regulated industries such as airlines, motor carriers, railroads, and insurance.
- Rate regulated industries are classified by type of regulation:
  - Individual cost of service — public utilities
  - Group rate setting — airlines, insurance, motor carriers, and railroads
  - Combination of individual cost of service and group rate setting — health care organizations
- The objectives of this project are threefold:
  - To determine whether there are circumstances that would support a different application of generally accepted accounting principles by regulated enterprises in general-purpose financial statements than is applied by nonregulated enterprises.
  - To identify any such circumstances, principally resulting from rate making, and to determine any impact they should have on the identification and measurement of assets, liabilities, revenues, and expenses.
  - To establish criteria for recognizing when circumstances exist that should be reflected in the application of generally accepted accounting principles by regulated enterprises.
- Impetus for the study came from the SEC and the AICPA's Accounting Standards Division.
  - The SEC requested the FASB to reconsider the Addendum, "Accounting Principles for Regulated Industries," to APB Opinion No. 2, *Accounting for the "Investment Credit."*
    - The Commission noted problems with the Addendum, such as confusion over the applicability of FASB Statement No. 13, *Accounting for Leases*, to rate-regulated enterprises, and, in general, defining what is not a rate-regulated enterprise.
  - The AICPA's concern stemmed from the variety of interpretations, in practice, of the Addendum, and the increasing difficulty of identifying the industries to which the Addendum should apply.
- The Discussion Memorandum includes eleven key issues and twenty-six subissues.
  - The threshold issue, to which an affirmative answer would render the remaining issues largely irrelevant, is, "Should accounting prescribed by regulatory authorities be considered in and of itself generally accepted for purposes of financial reporting by rate-regulated enterprises?"
  - The remaining ten key issues deal with such questions as:
    - Does rate regulation, or only specific types of rate regulation, introduce an economic dimension that should affect the application of generally accepted accounting principles?
    - Should any pronouncement on this subject issued by the Board identify specific industries affected, or should the pronouncement deal with concepts and criteria for application?
    - Should the financial statements of a regulated enterprise disclose the effect of differences between those statements and what they would be if the enterprise were non-regulated?
    - How should any new standards on accounting for the impact of rate regulation be applied?

## INVITATIONS TO COMMENT

### *Evaluation of FASB Statements in Effect at Least Two Years (Issued May 31, 1978)*

- Invites written comments from financial statement preparers, auditors, users and others about their experiences in applying FASB Statements Nos. 1-12 and in using the resulting financial information.
- Comments are invited, particularly on FASB Statement No. 5, *Accounting for Contingencies*, and FASB Statement No. 8, *Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements*.
- Comments on APB Opinions and Accounting Research Bulletins also are requested.
- Respondents are asked to state specific reasons for recommending re-examination of a pronouncement, and to set forth specific proposals for solution together with supporting reasoning. Proposals should include comments on:
  - The effect of the proposal on financial reporting of all classes of enterprises in all types of industries affected by a particular Statement.
  - Consistency of the proposal with the requirements of other existing pronouncements.
  - The possibility that further progress in the Conceptual Framework project will significantly affect the proposal.

(Comment period ended August 15, 1978)

Note: In response to comments received, the Board has added to its agenda a reconsideration of FASB Statement No. 8 an Exposure Draft, *Accounting for Foreign Currency Translation* was issued on August 28, 1980) deferred reconsideration of FASB Statement No. 5; and declined to reconsider ARBs Nos. 43 and 51, APB Opinions Nos. 4, 6, 9, 11, 15, 18, 19, 20, 21, 25, 26 and 30, FASB Statements Nos. 2, 3, 4, 6, 7, 9, 10, 11, 12 and 22 and FASB Interpretations Nos. 18 and 22.

### *Financial Statements and Other Means of Financial Reporting (Issued May 13, 1980)*

- Invites comments on guides to help the Board and others in deciding questions relating to different kinds of information provided by financial reporting by business enterprises.
  - Broad guides are described for questions of:
    - *What* information should be provided.
    - *Who* should provide the information.
    - *Where* should the information be provided.
  - The Invitation is part of the Conceptual Framework.
- *What* questions involve distinguishing kinds of information that should be disclosed in financial reporting by business enterprises from information that need not be provided or may be provided voluntarily.
- *Who* questions involve distinguishing between kinds of information to be provided by all business enterprises and kinds of information to be provided only by designated enterprises (for example, provided only by publicly-held enterprises or by large enterprises).
- *Where* questions involve distinguishing between the nature of financial statement information and the nature of information to be provided by one or more means of financial reporting other than financial statements, such as notes to financial statements or required supplementary information.

- This invitation to comment is primarily concerned with the following:
  - Required information in notes to financial statements,
  - Required supplementary information accompanying financial statements and notes,
  - Required supplementary information available on request.
- The Board is unlikely to become concerned with voluntary information.
- Questions of *what* and *who* are considered essentially the same question and are treated together.
  - The criteria for *who* and *what* are drawn from the Conceptual Framework and are relevance, reliability, and costliness.
- The question of *where* information should be presented may be treated as an independent issue, or as one that is interrelated with the *who* and *what* questions.
  - *Where* requires examination of such issues as:
    - Whether *where* considerations should be based on the information that is part of the “complete perspective” presented in the financial statements, or whether the information presents a “different perspective” of the enterprise (for example, historical cost vs. current cost).
    - Whether *where* considerations should be based on criteria of relevance, reliability, and costliness (for example, audited vs. unaudited data).
    - Whether *where* considerations should be based on “user perspectives”.
- Appendix B sets forth relationship of the Invitation to Comment to other phases of the Conceptual Framework project.

(Comment period ended August 15, 1980)

## RESEARCH REPORTS ISSUED

### *Field Tests of Financial Reporting in Units of General Purchasing Power (May 1977)*

### *Financial Accounting in Nonbusiness Organizations, An Exploratory Study of Conceptual Issues, R. N. Anthony (May 1978)*

- The study identifies and defines the issues of financial accounting in nonbusiness organizations, and is intended to assist the FASB to evaluate whether it is feasible and desirable for it to become involved in specific projects in this area.
- The study is organized to raise substantive issues and to give arguments, pro and con, with no attempt to resolve the issues. It covers the following topics:
  - It explores the current state of financial accounting and reporting by nonbusiness organizations.
  - It attempts to identify the users of external financial statements of nonbusiness organizations and their information needs.
  - It relates those user needs to information supplied by different types of financial statements.
  - It explores certain specific financial accounting and reporting areas that are controversial and nonuniform, such as pensions and depreciation.
  - It concludes by exploring the appropriate boundaries for a set of accounting concepts for nonbusiness organizations, including the question of whether separate accounting concepts are needed for nonbusiness organizations, and whether separate concepts may be needed for the governmental, nongovernmental, or other categories of the nonbusiness spectrum.

### *Economic Consequences of Financial Accounting Standards—Selected Papers (July 1978)*

- Includes papers presented at the FASB-sponsored Economic Consequences Conference held on March 23, 1978.
  - Research on economic consequences of financial accounting standards is being encouraged by the FASB to gain a better understanding of the following factors:
    - The types of economic consequences that accounting standards can have.
    - The processes by which "side effects" occur.
    - The nature and accuracy of the techniques available for measuring and predicting such "side effects."
- Six independent research studies are published in the Research Report.
  - "The Potential Effect of Alternative Accounting Measures on Public Policy and Resource Allocation," by D.N. Winn.
  - "Measuring the Impact of Floating and FASB Statement No. 8 on Costs of Capital for Multinationals," by J.H. Makin.
  - "The Impact of Disclosure Regulations on the Cost of Capital," by D.S. Dhaliwal.
  - "The Impact of Reporting Leases Off the Balance Sheet on Bond Risk Premiums," by A. Rashad Abdel-khalik, Robert B. Thompson and Robert E. Taylor.

- "The Economic Consequences of Financial Accounting Statements," by G.J. Benston and M.A. Krasney.
- "Accounting Changes in Principles and Estimates, How Different Are They?" by W.T. Harrison, Jr.

***Statement of Financial Accounting Standards No. 5: Impact on Corporate Risk and Insurance Management, Robert C. Goshay (October 1978)***

- The purpose of the report is to examine the impact of FASB Statement No. 5, *Accounting for Contingencies*, on the practice of corporate risk and insurance management—in particular, to determine if that Statement has caused enterprises to make unsound risk and insurance management decisions.
- Several hypotheses were tested by comparing a study group of 74 enterprises that had self-insurance reserves in the two years before Statement No. 5 was issued with a control group of 85 enterprises that had not established self-insurance reserves before the issuance of the Statement.
  - The main hypotheses tested were that Statement No. 5 encouraged enterprises to make economically unjustified decisions to purchase insurance or reinsurance, to increase coverage on insured exposures, to spend more for legal, loss protection and loss prevention services, and to alter insurance and reinsurance contracts between subsidiary insurance companies and their parent companies.
- The study revealed no significant differences between the risk management decisions of enterprises that had self-insurance reserves before Statement No. 5 was issued and those of enterprises that had not established self-insurance reserves before the issuance of the Statement.

***The Impact of Statement of Financial Accounting Standards No. 8 on the Foreign Exchange Risk Management Practices of American Multinationals, T. G. Evans, W. R. Folks, Jr., and M. Jilling (November 1978)***

- Attempts to evaluate the economic impact of FASB Statement No. 8, *Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements* on the foreign exchange risk management (FERM) practices of U.S. multinational corporations.
- A mail-survey technique was used as the principal method of acquiring the data upon which the results of the study are based.
- Evaluation of the impact on FERM of FASB Statement No. 8 essentially is based on a comparison of data collected in an earlier research survey, conducted in 1975, on the FERM practices of companies with the practices of those same companies and additional companies following the issuance of Statement No. 8.
  - Adjustments were made to reflect expected changes in FERM resulting from the normal growth in the volume of international business of the firms which responded to the survey.
- Some of the conclusions reached by the study are:
  - Firms whose accounting practices did not conform closely to Statement No. 8 when it was issued are pursuing more aggressive FERM programs. Therefore, Statement No. 8 did have an impact on the way that firms manage foreign exchange.
  - Statement No. 8 has had an impact on investment policies.



- Some firms have refrained from making foreign investments. Others have adjusted their "hurdle rate" due to exchange risk.
- Dividend payments from subsidiaries in weak currency countries have been accelerated by some companies to reduce their exposure.
- A major question that remains unresolved from the data made available is whether the increased level of resources devoted to the exchange risk management function has generated a significant increase in the after-tax cash flow of the multinational corporation.

***An Empirical Investigation of the Effects of Statement of Financial Accounting Standards No. 8 on Security Return Behavior, Roland E. Dukes (December 1978)***

- The objective of the research study is to investigate whether, in general, the common stock security returns of multinational firms were significantly affected by the issuance and implementation of FASB Statement No. 8, *Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements*.
  - Common stock security returns are defined as the change in share prices between the beginning and end of a period plus dividends received during that period, all divided by the common stock share price at the beginning of the period (adjusted for stock splits and stock dividends, where necessary).
- The study investigates the securities market behavior of firms affected by FASB Statement No. 8 both prior and subsequent to its issuance. The report discusses the research effort, provides a summary of the findings, and considers the limitations and issues yet to be addressed.
- The major finding of the study is that the issuance and implementation of FASB Statement No. 8 does not appear to have had significant detectable effects on the security returns of multinational firms.

***The Effects of the Issuance of the Exposure Draft and FASB Statement No. 19 on the Security Returns of Oil and Gas Producing Companies, T. R. Dyckman (April 1979)***

- Concludes that the issuance of FASB Statement No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies*, had no significant impact on the stock prices of oil and gas producing companies using full cost accounting relative to those using the successful efforts method.
  - Tests were conducted on oil and gas producing firms affected by the Statement by comparing the security return behavior (change in stock prices plus dividends) of the affected full cost firms with that of successful efforts firms for several weeks before and after the date of issuance of that document.

***Reporting of Service Efforts and Accomplishments, P. K. Brace, R. Elkin, D. D. Robinson, and H. I. Steinberg (November 1980)***

- Presents the results of a study of the reporting of service efforts and accomplishments information in 120 reports prepared by 6 types of nonbusiness organizations:
  - Colleges and universities.
  - Hospitals.
  - Human services organizations.
  - State and local governmental units.

- Trade and professional associations.
- Philanthropic foundations.
- The study was commissioned as part of the FASB's Conceptual Framework project on non-business organizations.
  - In the Exposure Draft, *Objectives of Financial Reporting by Nonbusiness Organizations*, issued in March 1980, the Board stated that, among other items of information, financial reporting should provide information about an organization's performance which includes information on service efforts and accomplishments of the organization.
- The purpose of the study was to develop information on the following aspects of the reporting of service efforts and accomplishments:
  - The users to whom nonbusiness organizations supply the information.
  - The ways in which nonbusiness organizations report this information, and why.
  - The types of documents in which the information is transmitted.
  - The degree to which such information is, or might be, characterized by relevance, reliability, and comparability.
  - The degree to which such information might be a useful feature of general purpose external financial reporting.
- The procedures used included:
  - Defining terms.
  - Establishing premises.
  - Gathering reports.
  - Recording data.
  - Reviewing literature and interviewing.
- Some of the findings of the study are:
  - Evidence of service efforts and accomplishments reporting was found in every kind of organization.
  - Information on efforts was found more readily than was information on accomplishments.
  - Information on efficiency was more prevalent than information on effectiveness.
  - In the area of service accomplishments the reporting of outputs was found readily, however, there was much less results information reported.
  - Trend information was not commonly found.
  - Most service efforts and accomplishments reporting was found in reports other than general purpose financial reports.
- Among the conclusions reached by the study team the following are particularly pertinent:
  - The state of the art in identifying and measuring inputs, processes, outputs and efficiency appears to have advanced to the point of being amenable to inclusion in financial reporting.
  - The state of the art concerning results is marginal; therefore, reporting on organizational effectiveness also is presently beyond reach.

- Inclusion of results information in financial reporting at this time may detract from, rather than enhance, the usefulness of financial reporting.
- Additional research with respect to identification and measurement of service results should be encouraged.

***Recognition of Contractual Rights and Obligations: An Exploratory Study of Conceptual Issues, Yuji Ijiri (December 1980)***

- The purpose of the report is to examine certain issues related to the initial recognition of assets and liabilities in financial statements.
  - The issues addressed concern the timing of simultaneous recognition of an asset and a liability that has no immediate impact on equity.
  - The recognition of subsequent changes in assets and liabilities accompanied by recognition of revenues, expenses, gains and losses are to be surveyed in another research report.
  - Recognition of owner's contributions and withdrawals is also excluded from this study.
- The study focuses on contractual rights and obligations because contracts are a common means of acquiring assets and liabilities without immediately affecting equity.
  - The issue of recognition arises because a significant period of time often elapses between the initiation of a contract and subsequent performance under the contract.
- The report considers the following alternative points for recognition of assets and liabilities, and evaluates each alternative based on the objectives of financial reporting and the qualitative characteristics of financial information.
  - Recognition points are: delivery, segregation, production, procurement, and contract or order.
  - Additional recognition points need to be identified if on the basis of a contract the supplier must take other actions, for example, in building a plant: the plant completion, the construction progress, the start of construction, and the contract.
- Possible recognition principles and criteria are set forth in the concluding chapter of the report.
  - Recognition of contractual rights and obligations requires that they meet the broad definition of assets and liabilities as set forth in FASB Statement of Financial Accounting Concepts No. 3, *Elements of Financial Statements of Business Enterprises*.
  - Recognition of contractual rights and obligations must also be justified on the basis that doing so produces information that is useful for decision making.
  - The concept of a firm commitment is introduced.
    - A commitment is said to be firm if it is unlikely that its performance can be avoided without a severe penalty.
  - A possible recognition principle is then set forth:
    - A contractual right or obligation should be recognized when it becomes firm.
    - Alternative recognition criteria are offered.

## PROCEEDINGS ISSUED

- *Financial Reporting and Changing Prices—The Conference*, Paul A. Griffin, Editor (June 1979)
  - Includes papers and special industry reports presented at an FASB Conference on Financial Reporting and Changing Prices held May 31, 1979 in New York City.
  - The Conference dealt with the following aspects of financial reporting and changing prices:
    - Its public importance
    - Effects on management decisions and actions
    - Impact on decisions by investors, creditors, and others
    - Perspective of the Securities and Exchange Commission
    - Implication for certain industries

## BACKGROUND PAPERS ISSUED

- *Accounting for Pensions by Employers* (March 1980)
  - The major concern of the FASB project on accounting by employers for pensions and other retirement benefits is the determination of periodic cost and liability, if any, to be recognized by employers.
  - The two types of pension plans identified are:
    - Defined benefit plans (plans that state the basis for determining the pension benefits retirees receive), and
    - Defined contribution plans (plans that define the employer contributions rather than the retirees' benefits).
  - The specific areas to be considered by the project include:
    - Determining an employer's pension obligation and the related cost,
    - Assigning that cost to specific accounting periods, and
    - Determining whether an employer participating in a multiemployer plan has a liability for unfunded defined benefits under the plan.
  - The FASB project will also consider accounting for other types of retirement benefits, such as continuation of life insurance and medical insurance after employees retire.

## TECHNICAL AGENDA PROJECTS—For which Discussion Memoranda or Exposure Drafts have not been issued to date (Date placed on Agenda)

- Accounting by Employers for Pensions and Other Postemployment Benefits (March 1975)
  - Includes accounting for termination indemnities
  - FASB Statement No. 36, *Disclosure of Pension Information*, issued May 1980. (Excludes other post retirement benefits.)
- Accounting Recognition Criteria for Elements (2nd Quarter 1979)
  - Research report by Y. Ijiri, *Recognition of Contractual Rights and Obligations* was issued in December 1980.
  - Research report by H. Jaenicke is in progress.

- Disclosure of Summarized Financial Information for All Material Investments Accounted for by the Equity Method (4th Quarter 1979)
- Current Text Codification (3rd Quarter 1980)
- Specialized Industries
  - The Staff and Task Forces are extracting the specialized accounting and reporting principles and practices in various AICPA Statements of Position and Guides. It is expected that these will result in Exposure Drafts of proposed Statements.
    - An Exposure Draft, *Accounting for Franchise Fee Revenue*, was issued December 1, 1980.
    - A first draft of an Exposure Draft has been completed for each of the following issues:
      - Revenue recognition when right of return exists.
      - Product financing arrangements.
      - Insurance companies.
- Other Concepts of Financial Reporting by Nonbusiness Organizations
  - Qualities of financial information of nonbusiness organizations.
  - Guidelines for differentiating financial information that should be included in financial statements and information that should be disclosed outside of financial statements.
  - Elements of financial statements of nonbusiness organizations.
  - Reporting organizational performance and identifying the relevant reporting entity.
- Shared Appreciation Mortgages (November 1980)
  - Considers the accounting for shared appreciation mortgages with emphasis on accounting for the lender.
- Capitalization of Interest Cost (December 23, 1980)
  - Will clarify the application of FASB Statement No. 34, *Capitalization of Interest Cost*, to consolidated financial statements in situations involving investments accounted for by the equity method.
- Transfer of Receivables with Recourse (December 1980)
  - Should transfer of receivables with recourse to the transferor be accounted for as a borrowing or as a sale?

**STAFF AGENDA PROJECTS – Not on FASB technical agenda at this date but under study by the Staff**

- FASB Statement No. 33, *Financial Reporting and Changing Prices*. Implementation Problems
  - Mutual Funds
- FASB Statement No. 34, *Capitalization of Interest Cost*. Implementation Problems
  - Netting Interest Income and Expense
- FASB Statement No. 34, *Capitalization of Interest Cost*. Potential conflict with other pronouncements such as certain AICPA Accounting Guides, Audit Guides, and Statements of Position

- Accounting for Dollar Reverse Repurchase Agreements
- Stock Option Plans Exercisable by Tendering Stock
- Personal Financial Statements
- Accounting for Bonds Whose Amount at Final Disposition Is Determined by Reference to the Market Value of an Asset
- Impairment of Long-lived Assets
- Consolidations

**INTERPRETATIONS AND AMENDMENTS IN PROCESS – For which Discussion Memoranda or Exposure Drafts have not been issued**

- *Title Insurance Companies, Real Estate Costs*
  - Will designate AICPA SOP 80-1 and SOP 80-3 as preferable accounting.

**RESEARCH REPORTS IN PROCESS**

- Recognition of Revenue and Expenses
  - Research is being conducted by Professor Henry Jaenicke of Franklin and Marshall College.
- Effects of FASB Statement No. 13, *Accounting for Leases*, On Stock Prices, Bond Risk Premiums, and Perceptions and Actions of Preparers and Users of Financial Statements, and Financial Statement Relationships
  - Research team is headed by Professor A. Rashad Abdel-khalik of the University of Florida.
- Understanding How Investors, Creditors, and Other Users of Financial Information Make Decisions
  - Research is being conducted by the FASB staff and Professor Paul Griffin of Stanford University.
- Summary Indicators
  - The usefulness of summary indicators in financial reporting, including indicators of the performance of an enterprise.
  - Research is being conducted by Professor Paul Frishkoff of the University of Oregon.

**OTHER MATTERS – Items proposed to the FASB by various parties but not yet placed on the FASB's technical agenda**

- Clarification of Reporting Practices Covering Hospital Related Organizations
- Bank Audit Guide
  - Should the proposed revisions of the AICPA Bank Audit Guide be added to the agenda?
- Disclosure of Related Party Transactions and Economic Dependency
  - Essentially, disclosures required by Statement on Auditing Standards No. 6, *Related Party Transactions*.



